

# HOW TO FORM AND MAINTAIN A NONPROFIT CORPORATION IN WASHINGTON STATE

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## Committee Members

[Andrea Brenneke](#), Co-Chair, MacDonald, Hoague & Bayless  
[Patrick Franke](#), Co-Chair, Leary Franke Droppert PLLC  
[Judith L. Andrews](#), Gottlieb, Fisher & Andrews, PLLC  
[Putnam Barber](#), The Evergreen State Society  
[Mark Griffin](#), Office of Economic Development, City of Seattle  
[Stephen Katz](#), Attorney at Law  
[Seema Nanda](#), Davis Wright Tremaine LLP

## Authors

[Judy Andrews](#), Gottlieb, Fisher & Andrews, PLLC  
[Nalani Askov](#), Attorney at Law  
[Putnam Barber](#), The Evergreen State Society  
[Sandy Deja](#), Exempt Advisory Services  
[Jeffrey Even](#), Assistant Attorney General, *State of Washington*  
[Rob Flemming](#) CPA, *Clark Nuber P.S.*  
[Bruce Goto](#), Riddell Williams P.S.  
[Tracey Hawk](#), Davis Wright Tremaine LLP  
[Dave Horn](#), Assistant Attorney General, *State of Washington*  
[Mark Hugh](#), CPA, Clark Nuber P.S.  
[Stephen Katz](#), Attorney at Law  
[Julia Kittross](#), Pacific Northwest Grantmakers Foundation  
[Seema Nanda](#), Davis Wright Tremaine LLP  
[LaVerne Woods](#), Davis Wright Tremaine LLP

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# Letter from Secretary of State, Sam Reed

**SECRETARY  
of STATE**

Sam Reed



Legislative Building  
PO Box 40220  
Olympia, WA 98504-0220  
Tel 360.902.4151  
Fax 360.586.5629  
[www.secstate.wa.gov](http://www.secstate.wa.gov)

March 8, 2001

It is an exciting time to start or become involved in a non-profit organization. In the Pacific Northwest and around the world, non-profit organizations are making a difference. They enrich lives and play a vital role in meeting the needs of our communities.

A non-profit organization is a business with special needs and considerations. It is important that prospective non-profit organizations understand these special needs, as well as the seriousness of the fiduciary responsibilities borne by non-profit organizations.

Non-profit organizations are often staffed completely by volunteers or lay persons, to whom obtaining and maintaining non-profit status may seem a daunting task. This handbook is produced by the King County Bar Association's Community Involvement Committee to assist you in the process of becoming a non-profit organization.

The Office of the Secretary of State is a reporting agency that maintains state registrations for non-profit corporations and charitable organizations. Depending upon its activities, a non-profit organization may be required to maintain one or more registrations with our office. The registration process is simple and inexpensive. Our friendly and knowledgeable staff members are available to provide assistance and answer questions pertaining to these registrations. For more information regarding registration with the Office of the Secretary of State, call (360) 753-7120 for our Corporations Division and (800) 332-4483 for our Charities Program.

Thank you for your interest in becoming a non-profit organization. We look forward to working with you and wish you well in your efforts.

Sincerely,

  
Sam Reed  
Secretary of State

SR: rm

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### **Author and Committee Members Biographies**

**Judith Andrews**

**Nalani Askov**

**Putnam Barber**

**Andrea Brenneke**

**Sandy Deja**

**Jeffrey Even**

**Rob Fleming**

**Pat Franke**

**Bruce Goto**

**Mark Griffin**

**Tracey Hawk**

**David Horn**

**Mark Hugh**

**Stephen Katz**

**Julia Kittross**

**Seema Nanda**

**LaVerne Woods**

## Introduction: Starting a Nonprofit Organization

### Are You *Sure* You Want to Do This?

Authored by: [Putnam Barber](#), *The Evergreen State Society*

The rest of this book explains carefully what you need to do to form and maintain a nonprofit corporation and tax-exempt organization in the state. The goal for this section is to persuade you to think twice – maybe even more often – before you start down that path. There are lots of strong reasons for adopting the nonprofit form as a home for many sorts of work. They will be discussed later in this introduction and in more detail in other chapters of this book. There are also other, often simpler and less demanding, ways of achieving many of the same ends. It makes sense to consider those possibilities first.

One early point of clarification: This book is focused on a few of the possible types of “nonprofit corporations” that are eligible for tax exemption under the Internal Revenue Code. Washington State allows the creation of a nonprofit corporation “for any lawful purpose.” There are narrower limits on the purposes that may qualify for exemption from various State and local taxes and the federal corporate income tax. Readers of this book will find detailed commentary related to “public charities” (usually recognized by the IRS under section 501(c)(3).) The rest of the more than 20 categories found in section 501 are suitable to limited and closely defined circumstances. Some of these categories are described in [Exhibit A](#) of this book. If your plans suggest seeking tax-exempt status under the terms of one of those other sections, this book is not likely to offer useful guidance.

Between 1990 and 1995, the Charities Division of the Office of the Secretary of State registered 16,189 new nonprofit corporations. In that same period, the number of registered corporations grew from 25,274 to 31,421, while 7,765 nonprofit corporations dissolved or went out of business. The implication: in that same period, at least 13,912 nonprofit corporations stopped operating, failed to renew their registrations with the State of Washington, and vanished without a trace.

The State Nonprofit Almanac 1997, uses information from federal sources to estimate that Washington State had more than 12,000 recognized 501(c)(3) organizations circa 1992. Of these, only 3,363 (less than a third) received more than \$25,000 in revenue. In fact, nearly 80% of all the expenditures made by recognized public charities in Washington State in that year were accounted for by the 2.3% of organizations with budgets over \$10 million. The implication: most nonprofits operate on a shoestring. Gathering public support for a new organization is very difficult. Those that start without a clear path to financial stability can expect an uphill struggle.

These daunting statistics are not enough to discourage all comers though. The vitality, security, cultural landscape and spiritual life of Washington’s communities are continuously renewed by the contributions of nonprofits and the people who support them. The new organizations being formed every year make valuable and often unexpected contributions to the quality of life for all of us. If you are among the committed and brave individuals who have set yourself on the course of adding

to the assets of our communities in this way, more power to you. Everyone associated with the production of this book wishes you nothing but the best.

## Decisions to Make Before You Start

Before you can complete the requirements for a new nonprofit corporation, you will need to decide whether it is to be a *mutual benefit* or a *public benefit* organization and, if a public benefit organization, whether it will be exempt from federal taxes as a *social welfare organization* or a *public charity*. If your choice is to be recognized as a public charity, then you will need to take steps to ensure that you are not classified by the IRS as a *private foundation* – unless, of course, that is the right designation in your case.

All of these questions are addressed in detail in [Chapter II](#) of this book (*Obtaining Tax-Exempt Status for Your Nonprofit Corporation*). Before you complete the process, you will need to know a good deal about what they mean and how the choices you make will affect the way your new organization can work to meet its goals.

As the name implies, *mutual benefit* organizations are formed and operate primarily for the benefit of some identifiable group, often called “members.” Examples include business leagues and condominium associations, social and recreational clubs, and “improvement” groups like mutual water companies. *Public benefit* organizations include the familiar “religious, scientific, charitable and educational” groups often loosely described as “charities.” Their goals and purposes usually confer the benefits of their work broadly on large categories (“the people of the Puget Sound region” or “industrious youth”) or on the public at large. *Social welfare* organizations are usually focused on achieving their goals through advocacy and other efforts to influence public policy. Characteristically they forego the ability to accept routine foundation grants and tax-deductible donations from individuals in return for broad freedom to intervene in policy disputes without concern for the limitations imposed in federal law on the lobbying activities of charities. Washington law offers a choice between incorporating as a standard nonprofit under rules appropriate to public benefit purposes and more flexible rules for mutual benefit corporations; see the [Note 1](#) at the end of the introduction.

*Public charities* are federally recognized tax-exempt organizations that receive the bulk of their financial support from operating income and relatively small donations from relatively large numbers of sources. Most public-benefit organizations, unless formed to be foundations, will want to operate in a way that meets the criteria for recognition as a public charity by the IRS.

Federal law imposes greater constraints on the operations of organizations that cannot meet the “public support” standards established for public charities and designates them as *private foundations*.

There are some more fully fundamental issues you need to work through before you begin. The first is the careful definition of who will benefit and how from the work of the new organization. One powerful influence is your decision whether or not to have members.



## Will you have members?

Washington State law says very little about membership in nonprofit organizations. (See [Chapter I](#) of this book.) The basic point is that the organizers of a new corporation can set the terms and conditions of membership in almost any way they please. Once specified in the articles of incorporation and bylaws, though, these terms and conditions must be followed carefully if the organization is to serve the community honorably and effectively. Changing them later may be difficult, especially if the impulse to do so arises at a moment of organizational crisis, when lines may be sharply drawn and suspicions aroused.

The decision over whether to be a membership organization or not rests on the process for the selection of the board of directors. In the widely used *associational* model, the members of the organization elect the directors in a democratic process. It is impossible to summarize the variety of arrangements that have been invented to serve the needs of organizations of various sorts. Often there are eligibility and voting standards set up to assure adequate representation from various classes of membership or geographic areas. Stability is sometimes built in by having overlapping terms so the entire board is not replaced at one election. On the other end of the spectrum, many boards have limits on the length of individuals' terms and other mechanisms to ensure turnover of directors.

Some observers maintain that it has become increasingly difficult to guarantee wide participation in organizational elections. Organizations that choose the associational form need to give careful attention to dealing with the difficulties that would follow if the level of participation falls below what is required for a valid election.

## Self-Perpetuating Board

It is also common for nonprofit corporations to be formed with *self-perpetuating* boards. The board itself elects new directors. The articles of incorporation or bylaws will define the procedure to be used. They may offer a process by which the members may contest the decisions of the board under certain conditions.

The self-perpetuating model is easier to operate. It cuts the organization off from one direct mechanism by which the interests of the wider community can be brought to bear on its work. Having a self-perpetuating board lends extra urgency to the work the members of the board of directors do to perform that function. Many organizations with such boards will have formal procedures that ensure attention to community needs and interests. Mutual-benefit organizations may have some "market" mechanisms that lead toward this result, if membership falls or attendance at the annual conference starts to slip, the board and staff will no doubt give increased attention to what the membership wants.

Once you have thought these questions through, you will be in a position to design the way you want your organization to work and start the task of drafting articles of incorporation and bylaws. The technical details of those documents are discussed in [Chapter II](#) of this book. Because of their lasting influence on the organization these formative decisions will require careful thought in the

early stages. The nub of this decision-making process will be found by posing the question about how your new nonprofit organization will ensure that it continues to meet the needs of the community or the desires of its members over the long haul. Specifying how the board and/or membership of those involved in the organization will work together, and how both will represent a wider community of interest, is the hard part of translating your vision into the paperwork required for incorporation. The time to do this work is at the very start.

## Feasibility Study

Before the organization is formed, though, there is no board and no membership. A small group of enthusiasts may be convinced of the value of what they want to do. Common interests may have convinced a circle of organizers of the need for a new organization. A promising opportunity, such as an announcement of a government program or an offer of philanthropic support, may also create interest in forming a new organization. Continuing broad public support is elusive. It comes only to an organization with a well-articulated purpose and distinctive mission. A feasibility study offers one way to find out whether the energy of the founders will be met with the necessary sustained response from a wider group.

The techniques of conducting feasibility studies have been worked out to help nonprofit organizations decide whether the time is ripe to launch a capital campaign. Similar logic applies to the question of whether to form an organization in the first place. The key questions are: Will your organization's closest and most committed supporters take the lead in assuring continuing support for its work? Is the wider community likely to join in with further support at a level that will make the planned program feasible? Hard as it is, it is better to find out that the likely answer is "no" before you and the other founders invest many hours of personal time, and no small amount of money, in putting together an organization that cannot be sustained.

Implicit in the design of a feasibility study is a fundamental truth about nonprofit organizations: They depend on the support of a core group of committed supporters for the resources they need to start up, and to continue to operate effectively. For every story about someone receiving an unexpected six-figure donation from a far-away admirer, there are thousands of stories of worthwhile organizations that simply did not have a circle of strong and willing friends who were committed to doing the day-to-day tasks necessary to keep the doors open. The simple outline of a feasibility study consists of nothing more than testing the breadth and depth of supporters' commitment to your organization's mission and program, followed by assessing the likelihood that other supporters can be found quickly and efficiently enough to make it possible for the organization to achieve its goals. Conducting a feasibility study involves no more than describing the proposed organization to a reasonable list of current and potential supporters, listening carefully to the replies, and making a sober assessment of what has been said.

There are two strong reasons why someone from outside the circle of founders should do this work: If you ask the questions yourselves, people may be reluctant to rain on your parade and thus couch their answers in the gentlest possible terms. If you are optimistic about what you want to do, you may not give as much weight as you should to the cautions and doubts people express as you are talking with them. There are consulting firms that specialize in conducting feasibility studies and a

responsible job can be done in many cases for a few thousand dollars. If the results steer you away from a frustrating run at a lost cause, the investment will have been a good one. If the consultant identifies potential supporters you would not otherwise have reached, the investment is even better. If spending that amount of money is beyond your reach in the early stages of organizing, you will need to devise some other strategy for getting straight answers and paying attention to whatever negative nuances the study may turn up.

Elements of a Feasibility Study	
<div> <div>■</div> <div>Description of the planned program.</div> </div> <div> <div></div> <div>List of potential supporters who already know about the program.</div> </div> <div> <div></div> <div>List of potential supporters in the wider community.</div> </div> <div> <div></div> <div>Standard list of questions to be asked.</div> </div>	<div> <div></div> <div>One or more careful interviewers.</div> </div> <div> <div></div> <div>Schedule for interviews.</div> </div> <div> <div></div> <div>Process for compiling a report of the findings.</div> </div> <div> <div></div> <div>Careful review of findings.</div> </div> <div> <div></div> <div>Clear decision about</div> </div>

	whether or not to proceed.
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## Private Foundation

If the organization you are thinking about creating will be a 501(c)(3) organization, then you will need to review carefully the distinction between a public charity and a private foundation, which is explained in [Chapter II](#) of this book (*Obtaining Tax-Exempt Status for Your Nonprofit Corporation*). Private foundations operate under more restrictive rules than do public charities, and are subject to certain taxes that do not apply to public charities. Every organization recognized as tax-exempt under section 501(c)(3) is considered by the IRS to be a private foundation unless it meets one of the tests in the law that demonstrate it is not. For most organizations, the relevant test is whether or not the organization receives broad public support. Each organization must determine, based on its revenues, that it meets one of the tests for broad public support in order to retain its status as a public charity.

## Accounting for Functional Expenses

On the subject of accounting, there is one further aspect of nonprofit operations that will probably be unfamiliar to newcomers to the field. Many nonprofits, especially those that seek financial support from the public, are required by the IRS and State charity regulators to report their annual expenditures in “functional” categories. The “functions” in this case are known as *program services*, *fundraising*, and *management and general expenses*. The government agencies simply require that these amounts be calculated, following generally accepted methods of accounting, and shown on the organization’s official reports. Some federated campaigns (United Way, for example) and other funders, have eligibility standards or other restrictions that set limits on the amounts that an organization spends on management and general or fundraising categories. Many states now publish a summary based on the reports received from registered organizations. Washington State’s website at <http://www.wa.gov/sec/charities> has that information. The IRS is working to publish financial information about many categories of nonprofits at <http://www.guidestar.org/>.)

Many donors look at organizations in which the proportion of expense committed to program services is felt to be “too low.” Many start-up organizations find it difficult to meet such expectations in the first few years of operations. That difficulty is compounded if the cause being served is controversial or obscure.

One of the challenges of starting a nonprofit organization is setting up an accounting system. It will need to meet the requirement to report expenses in these three functional categories and classify income received in the format required for demonstrating that the public support test is being met and the organization qualifies as a public charity.

## Lobbying and Political Action

Brian O’Connell, then president of the influential association of nonprofits known as Independent Sector has commented, “Political action is the quintessential function of nonprofit organization.” There are limits on the scope of lobbying and other political activities of nonprofits. Some are absolute: 501(c)(3) organizations are simply prohibited from any activities focused on influencing the outcome of elections. Some limitations are vague enough to be a source of uncertainty even for experienced nonprofit leaders. If your planned program includes any activity in matters of public policy at the local, state or federal level, you need to consider carefully how these limits will affect your program and the sort of organization you form.

The limits on political activities are not set just by the rules that govern nonprofit organizations. In Washington State, the policies of the Public Disclosure Commission and some municipal watchdog agencies may apply to any person and any type of organization that takes an active role, even a small one, in elections or tries to influence the decisions of legislators, council members, or other elected officials. The risk of embarrassment, not to mention financial and other penalties, offers strong encouragement to review these rules before getting involved in public policy discussions.

It is important to understand these rules precisely because it is an essential element of many nonprofits’ mission and purpose to influence for the better the way our communities work, how public institutions do their jobs, and how the public interest is expressed through the programs and funding decisions of governing bodies. The fact that there are limits does not mean that the limits stifle all action. Once the rules are understood and followed (see [Chapter IV](#) of this book), nonprofit organizations have a constitutional right and time-tested duty to engage strenuously in policy development and in the struggles over the correct direction to be taken in a myriad public issues.

Complying with the limits does mean, though, that there is one more type of specialized accounting that nonprofit organizations are required to do. The annual informational return many nonprofits file with the IRS to document continued eligibility for tax-exempt status requires a report of lobbying expenditures. It also requires a report of expenditures for electioneering for 501(c)(3) organizations; any such expenditures risk penalties. When setting up the financial controls and procedures for your new organization, give thought to systems that will make it easy to capture the expenses needed for preparing this report and develop the policies that will make it clear to everyone involved with your organization just what limits on political activity must be observed.

## Alternatives to Incorporating

If the previous few paragraphs have given you second thoughts about whether you want to get into this or not, they have done their job. Unfortunately, the option of just getting on with it – starting to do the work you want to do without going through the formalities of forming a corporation – is not really very attractive. For one thing, no bank is likely to open a checking account for an organization unless you can provide them with a properly executed banking resolution adopted by a board of directors. Using your personal checking account for the organization’s business, even if you are scrupulous in the way you account for every penny, invites suspicion from others involved

in the project and might complicate your own personal tax situation if there should ever be a question about your personal returns. The protection against certain kinds of personal liability for things that the organization does will not apply if the organization does not have the separate legal “existence” provided by incorporating. You expose yourself to a real risk of having to spend your own money and time to defend against a lawsuit or other legal action.

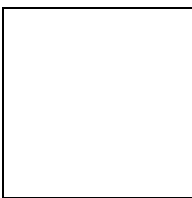
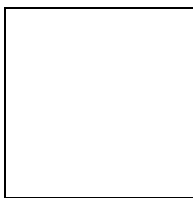
Washington’s Charitable Solicitations Act (RCW 19.09) applies to all fundraising done for charitable purposes from the general public. If your organization is going to engage in any fundraising of that sort, it will be necessary to register with the Charities Division in Olympia (see [Chapter VI](#) of this book) whether you are incorporated or not.

Putting a formal structure in place is a good solution to overcome difficulties. [Chapter I](#) of this book, discusses the steps necessary to create a Washington nonprofit corporation can be accomplished pretty easily. The other parts of starting and running a business in Washington State, whether as a nonprofit or for-profit entity, can be demanding.

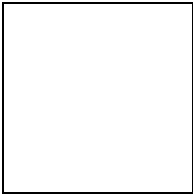
For many newly formed nonprofits, obtaining federal tax-exempt status and establishing eligibility to receive tax-deductible donations are still the most difficult steps in the process. For both state and federal purposes, as well as for internal management and control, you will need to set up bookkeeping and other procedures to assure that you can track and classify revenues and expenditures to meet the needs of the organization you establish.

One option is to begin your work as a “program” of an already established nonprofit organization of the appropriate type. If what you are planning to do would probably qualify for tax-exemption under section 501(c)(3), for example, then you would look for a suitable 501(c)(3) organization willing to adopt your activities and provide a legal and administrative home for your project. Becoming a “program” in this sense means entering into an agreement with the established organization specifying how the details of the arrangement will be handled. You can begin to do the real work that interests you much more quickly and at less expense.

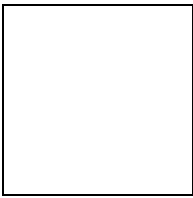
This sort of arrangement is known as “fiscal sponsorship.” There are some rules and principles of good practice that apply to such cases with special force. The little book, *Fiscal Sponsorship: 6 Ways to Do It Right* by Gregory L. Colvin (San Francisco: Study Center Press, 1993), offers the advice you need to get started negotiating such an agreement once you find a suitable host. A few basics will help you decide whether to explore this option instead of forging ahead to form an independent nonprofit organization immediately.

Basics of Fiscal Sponsorship	
	
The project’s mission and purpose must be consistent with	Fiscal sponsorship agreements usually provide for

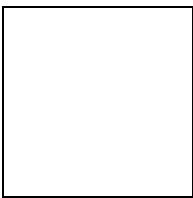
the exempt purposes of the sponsor.



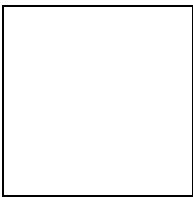
The board of the sponsor is ultimately responsible for the behavior of the project and its personnel.



Donations may be made to the sponsor and earmarked for the project. If the sponsor is eligible to receive tax-deductible donations, the donor may take any permitted tax deduction.

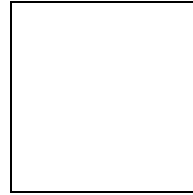


The sponsor may provide many administrative services – human resources, accounting and payroll, planning, public relations, etc.

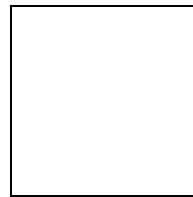


Financial and other reporting will consolidate the activities of the project with all the other activities the sponsor for most purposes; separate reports may be prepared for use internally and by the project.

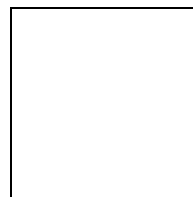
payments by the project to the sponsor based on some measure of the sponsor's services to the project.



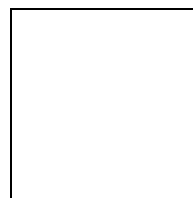
There may be a time limit, or the sponsorship agreement may end when the project obtains federal tax-exempt status on its own.



Projects often have their own letterhead, use conventional personnel titles (such as Executive Director), and otherwise appear quite independent to outsiders.



There may be a policy panel that oversees and gives direction to the project; the members of this panel may be the prototype for the board of directors that will lead the project if and when it becomes independent.



Care should be taken to specify fully the relations between this panel and the board of the



	sponsor.
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Many organizations have found that fiscal sponsorship offers a low-cost and low-hassle way of testing the waters. The great advantage is that there is only one complicated step that must be completed before work can begin – the negotiation of the sponsorship agreement with the established organization that will house the project during the formative stages. All the other necessary steps can wait until the fundamental viability of the new organization’s vision and mission have been tested and found to be sound.

Negotiating the sponsorship agreement will raise many of the same questions. Are there State and local taxes that this project must be prepared to pay? How do its services fit into the definitions of eligible tax-exempt purposes in the Internal Revenue Code? What insurance and other risk-management practices need to be in place to assure clients, staff, volunteers and supporters that due care has been taken to guard against avoidable risks and prepare for the possibilities of damage or loss? (See [Chapter III](#) of this book) These are good questions to ask at the start of any new project. The advantage of doing so in the context of negotiating a sponsorship agreement is that there is only one other party with whom you must work. In the normal course of events, that other party is experienced in the ways of the nonprofit world and has already established relationships with the local, state and federal authorities with which you will have to deal.

## Onward - Getting Started

It is important not to let these tough questions and technical details overwhelm you. The traditions of community service and mutual support that characterize the nonprofit sector of American life have been historically a vital part of our communities. There are hundreds of thousands of recognized nonprofit organizations at work all across the country today. Each of them had its start in the same way – a small group of dedicated people gathered in a room somewhere and committed to each other that they would do the work necessary to bring a new organization into being. Some started small and have remained small. They meet some specific need in some continuing way. Others have grown to be such familiar features of our communities that it is hard to imagine the moment when they began as nothing more than an idea and a shared vision.

Whatever the future holds for the idea that brings you to reading these pages, the authors of this book wish you the best of luck and great success in your efforts to benefit the community. If these chapters smooth the way for you to meet those goals, the work of putting them together will have been well worth it.

## Note 1: On the Types of Nonprofit Corporation Under Washington Law



While this book primarily focuses on the *Washington Nonprofit Corporation Act*, Washington State law recognizes a number of different forms of nonprofit corporations. Each of these different corporate varieties are described in different chapters contained in Title 24 RCW.

The two principle forms are nonprofit corporations formed under the *Washington Nonprofit Corporation Act* (chapter 24.03 RCW), and those formed under the *Washington Nonprofit Miscellaneous and Mutual Corporation Act* (chapter 24.06 RCW). Title 24 also contains a number of other chapters, each of which are significantly older than the principle acts.

## **Washington Nonprofit Corporation Act (RCW 24.03)**

The Washington Nonprofit Corporation Act (“the Act”) has been the principal statutory framework for nonprofit corporations in this State since it first became effective in 1969. Corporations may be formed under this Act for a broad variety of nonprofit purposes. The statutory recitation of permissible purposes includes virtually all purposes commonly associated with nonprofit or charitable activities, including charitable, religious, educational, civic, patriotic, political, and scientific organizations, among many others. The Act prohibits only the organization of labor unions, cooperative organizations and banking or insurance organizations under this chapter.

The breadth of application of chapter 24.03 makes it the basic nonprofit act for the State. The Act, however, prohibits nonprofit corporations from engaging in a number of activities. These limitations include prohibitions against issuing shares of stock, distributing income to members, directors, or officers, or loaning money or credit to officers or directors. These limitations on nonprofit corporations organized under the Act may pay reasonable compensation to members, directors or officers for services rendered, confer other benefits consistent with its purpose and make distributions to its members upon final liquidation, as permitted by law

## **Nonprofit Miscellaneous and Mutual Corporation Act**

While most modern nonprofit corporations are formed under the Act corporations formed for some purposes must instead be formed under the Act. This chapter is formally entitled the *Washington Nonprofit Miscellaneous and Mutual Corporation Act*, but corporations created under it are less formally referred to as mutual benefit corporations. *The Mutual Corporation Act* can be used to organize corporations for purposes prohibited under the Act, including labor unions and cooperative organizations. It can also be used to form social clubs, fraternal societies, or service organizations.

A mutual benefit corporation is permitted to perform a number of actions that are prohibited for nonprofit corporations organized under the Act. Mutual benefit corporations can issue stock. They can distribute surplus funds to members, stockholders, or other persons consistent with the terms of the articles of incorporation. Upon dissolution they can distribute remaining assets to their members, shareholders, or others, without some of the limitations that would apply to nonprofit corporations organized under the Act.

The distinction between a mutual benefit corporation and a chapter 24.03 nonprofit corporation relates to the purposes of the corporations. Many corporations formed under the Act have

charitable or religious objectives. They are generally organized to benefit society in general or to serve a larger cause than simply the personal interests of their members.

Mutual benefit corporations, by contrast, are formed to provide for the mutual benefit of the members of the corporation. They may provide real and tangible personal benefits to their members. Examples might include social clubs that provide benefits in the form of social events for members, or homeowners associations formed to hold title to and administer common areas within a neighborhood or condominium.

The Mutual Benefit Act statutorily parallels the Act to a large degree. Statutes cited in this book to chapter 24.03 often have parallel provisions in chapter 24.06, organized in roughly the same manner, which may or may not differ in some material way.

## NOTE 2: Won't Foundations Foot the Bill?

Authored by: [Julie Kittross](#), *Philanthropy Northwest*

“I can get start-up money from a foundation, can't I?” After all, start-up funding for a new nonprofit organization is something that private foundations do, isn't it?

Yes, sometimes. Foundations and corporate giving programs will occasionally provide start-up funding for new ideas, projects, and organizations. It isn't something that anyone hoping to start a new nonprofit organization should count on.

For the past eight years, I've managed the former Pacific Northwest Grantmakers Forum, renamed Philanthropy Northwest (“PN”). Our membership consists of 155 foundations (family, independent, public, community, corporate), corporate giving programs and other grant making organizations based in the five Northwest states.

While managing the PN, I've heard from a wide variety of private funders about what “bugs them the most” with respect to requests for funding grants. At the top of the list are requests from individuals who assume that their idea for a new nonprofit is the best thing since sliced bread, that it serves a unmet need and therefore should be fully funded by foundations until they get their feet on the ground and after. Particularly distressing to private funders are those individuals who see the establishment of a nonprofit as merely a way to create their own personal “dream job.”

It is the rare nonprofit that gets its start solely with foundation and corporate charitable giving support. In general, if an organization receives more than 10-15% of its income from donations by such organized private funders it is doing quite well.

When foundations and corporations become interested in start-up nonprofit endeavors, usually it is because they are already deeply involved in this particular issue or area. Working closely with nonprofits already laboring in that area or issue, they collaboratively agree that a new organization or project is needed in order to address a particular niche. The usual scenario is that the funders themselves start the ball rolling, seeking expertise in the community to accomplish the goals or meet the hitherto unmet needs they've identified.

I've spoken with dozens of entrepreneurially-minded visionaries who didn't have a clue that organizations already existed that were attempting to address similar problems in similar ways. Before accepting the huge responsibility of growing an organization from scratch, it is important to find out if an already existing organization, with similar goals, might want to adopt your project idea or be willing to act as a fiscal sponsor and allow you to operate your program concept through their existing nonprofit organization.

This isn't to say that there is no chance for a savvy and thoughtful individual to identify a need and establish a new nonprofit organization to meet that need. After all, every nonprofit organization was a start-up at some time.

You must “think twice and maybe even more often before you start” building a new nonprofit. This is analogous to the carpenter’s injunction to “measure twice - cut once.” Remember, the goal is to achieve the goal! You should carefully weigh whether the best way to achieve the goal is through the establishment of a new entity competing for the limited funds of the philanthropic community or by using the already existing nonprofit infrastructure in your community.

# CHAPTER I

## Incorporating and Establishing Your Nonprofit

**Authored by:** [Judith Andrews](#), *Gottlieb, Fisher & Andrews, PLLC*

This chapter will discuss the legal requirements and procedures for establishing a nonprofit corporation under Washington State law. It will walk you, on a step-by-step basis, through the procedures to incorporate and start up your nonprofit organization. It will also point out some important organizational issues, which you will want to address while drafting the necessary documents.

### A. The Washington Nonprofit Corporation Act

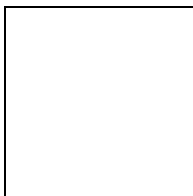
As described elsewhere in this handbook, a corporation is a legal entity created and organized under the authority of state law. Under law, a corporation is considered a “person” and is separate from its founders, members, directors and officers. An organization becomes a corporation by following the legal process for establishing a corporation, commonly called “incorporation.” Most nonprofit organizations, particularly those which will also be exempt from federal income taxation, become incorporated under the *Washington Nonprofit Corporation Act* (“the Act”). The Act provides the legal framework for forming and operating a nonprofit corporation in Washington State.

#### 1. Corporate Powers

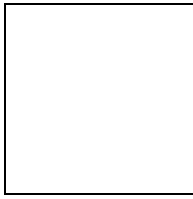
The Act gives nonprofit corporations a broad range of powers. The powers described in the Act are as broad as those given to for-profit corporations and include the power to purchase, own, lease, sell, convey, mortgage and otherwise deal in property, lend money or credit (except to members, officers and directors), make contracts, incur liabilities and borrow money, lend money for corporate purposes and invest funds, be involved in legal actions and make donations for the public welfare or for charitable, scientific or educational purposes.

#### 2. Limitations

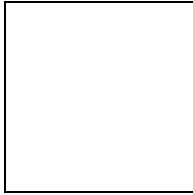
The Act places several significant limitations upon nonprofit corporations. Under the Act, a nonprofit corporation may not:



Have or issue shares of stock; or



Make any disbursement of income; or



Loan any money or credit to its members, directors or officers.

In addition, at dissolution or final liquidation, assets must be appropriately distributed. This will be described in more detail below under the discussion of the Articles of Incorporation.

## **B. Organizational Issues**

Before moving into the practical legal discussion of how to draft the legal documents and incorporate, you should be aware of several organizational issues that frequently arise during the early stages of forming a nonprofit organization. It will be beneficial to you and your organization to discuss and resolve these issues in the planning stage of forming your organization. These issues fall into four categories: membership, board of directors, decision-making style and mission.

### **1. Membership**

Under the Act, a nonprofit organization may have members or it may be a “nonmembership” corporation. Members may be persons or corporations. Under the Act, members have certain voting rights. Members have the right to vote on such issues as the election of directors to the board of directors, amendments to the articles of incorporation, merger or dissolution of the corporation and several other important matters. With proper provisions in your organization’s documents, you can give members the right to vote for all or some of these purposes and not others or you may have members who have no voting rights at all.

The decision whether to have members or not and what rights to give members relates to the nature and purposes of the corporation. Membership is often considered when an organization plans to raise funds from its supporters or seeks active participation by a large group of people. Membership may help encourage supporters to volunteer for the organization because they feel a greater sense of belonging. However, some organizations may find that the burden of obtaining a membership vote to carry out certain organizational actions such as electing directors outweighs any benefit to having members. This can be particularly so as an organization grows larger.

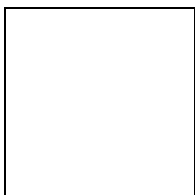
It also important to consider the procedures under which membership rights are granted. Such considerations include the amount of notice to give members for meetings, the number of members needed to constitute a quorum, and whether voting by proxy will be permitted.

## 2. Board of Directors

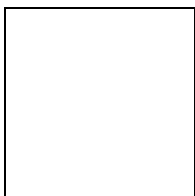
Under The Act, the governing body of a nonprofit corporation is called the “board of directors,” and the individuals who serve on the board are referred to as “directors.” Sometimes nonprofit organizations call their board a “board of trustees” and refer to the members of the board as “trustees.” Either form of terminology is permitted in Washington. For purposes of this handbook, the terms “board of directors” and “directors” will be used.

The board of directors manages the business affairs of the corporation. Usually, this means that the board sets policy, adopts and oversees the budget, hires the executive director and makes other major decisions for the organization. Sometimes, particularly as organizations are just starting up, the board of directors is involved in the day-to-day management of the organization.

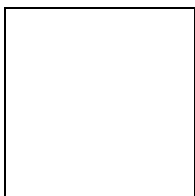
As you look to recruit a board of directors for your organization, you will need to decide such issues as how many directors to have on the board, how long directors will serve and what kind of individuals you want to have as directors. Factors in making these decisions include:



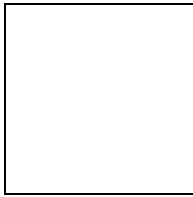
Whether the board is intended to represent the community the organization will serve or the community in which the organization will be active.



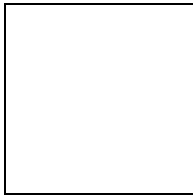
What role the board will take in fundraising. Will individual directors be asked to make a contribution and is the contribution a significant one? Do you intend to rely upon board members for connections into resources such as businesses or foundations? Will the board be planning and putting on fundraisers for the organization?



Whether the organization will rely on particular expertise that the organization cannot afford to purchase, such as legal or accounting skills.



Whether the board will be setting policies on substantive issues that will become important to the organization's mission or functioning in its community.



Whether there is a particularly long "learning curve" to become involved in the organization.

### **3. Decision-Making Style**

While focusing on the role of members and directors in an organization, it is important to consider how these bodies will make decisions. This issue involves factors such as quorum (the number of persons needed to hold a meeting in which action can be taken) and numbers of votes of those present needed to take action.

Factors to be considered include whether process and consensus decision making is important to the organizers, the level of formality that will be expected in meetings or the numbers of persons expected to participate in membership and/or board meetings. For example, if larger numbers of persons are involved, you may wish to have a lower quorum number to make it easier to hold a meeting and take action. If participation by members or directors is important, you might wish to have a higher quorum number to ensure that a few active members do not make decisions. More formality and larger numbers of persons may recommend adoption of Robert's Rules of Order or similar rules to help keep the meetings running smoothly.

### **4. Mission Statement**

If you have not done so, it is important to develop a mission statement for the organization. A clear, succinct mission statement becomes the basis for developing purposes of the organization, as well as a necessary tool for raising funds, recruiting directors and volunteers and planning activities and programs of the organization.

## **C. Nuts and Bolts of Incorporation**

The actual creation of a nonprofit corporation under Washington law is a fairly straightforward process. The basic steps discussed below will give you information on both the legal requirements and the practical tasks involved. You may find the Formation Checklist appearing on [Exhibit D](#) to be helpful as you are going through the process.



## 1. Name

**Significance of Your Organization's Name.** A name signifies a message. The name of your corporation should convey a message consistent with your organization's mission. Your corporate name should tell what your organization is about and at best, the name should arouse interest in your organization.

Sometimes both the name and its abbreviation or acronym can convey a message. For example, both "Progressive Animal Welfare Society" and the abbreviation "PAWS" express the organization's mission to protect animals.

**Legal Requirements for a Name.** While your chosen corporate name may be creative and catchy, there are certain things it cannot be. The organization's name:

CANNOT be the "same as or deceptively similar to" an existing or reserved corporate name, or limited partnership or limited liability company name.

CANNOT include or end with "incorporated," "corporation," "company," "incorporated," "limited partnership," Ltd," or any other corporate designation.

CANNOT describe the purpose of your organization in a misleading way. Any word or phrase, which indicates that the corporation is organized for any purpose other than the purpose contained in the Articles of Incorporation, is not permitted. For example, if your organization plans to work on AIDS, you should not call it "The Cancer Foundation."

CANNOT be in a foreign language unless the name is spelled with letters from the English alphabet. For example, El Centro de la Raza is permitted because it is spelled with English letters.

Your organization's name can include words such as "club," "league," "association," "services," "committee," "fund," "society," "foundation," or "[your corporate name], a nonprofit corporation."

**Availability and Reservation of Name.** Once you have chosen a name for the organization, you must determine if some other organization already has used the name or a name similar to it. If no other organization has chosen the name, it is available for your organization's use.

To determine if the name is available, you must check with the Corporations Division of the Secretary of State. At the same time, you may reserve the exclusive right to use the corporate name, so that it will still be available when you file your Articles of Incorporation.

To see if a name is available and reserve an available name, mail a reservation request form or a letter of request to the Corporations Division with the reservation fee. You can submit up to three different names. Upon receipt of the request, the Corporations Division checks the request against its master files. The first available name is reserved for you for 180 days. The reservation can be extended once more for another 180 days. If none of the proposed names can be used or reserved, your reservation fee is returned.

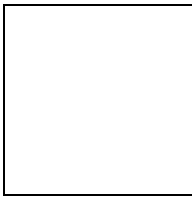
**CAUTION:** DO NOT order letterhead, stationary, business cards or any other printed materials with the organization's name until you have reserved the name.

## 2. Articles of Incorporation

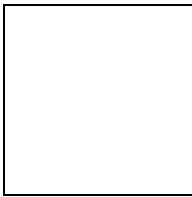
The articles of incorporation and the bylaws constitute the organizational and governing documents of a nonprofit corporation. The articles of incorporation create the corporation under state law. The bylaws provide the rules under which the corporation operates. The articles and bylaws should not have provisions which conflict with one another and, at best, should interrelate with one another. Except with respect to the number of directors, provisions of the articles will control over provisions of the bylaws where such provisions are inconsistent.

Sample articles of incorporation are attached to this book as [Exhibit A](#). The Secretary of State's office provides a form of articles of incorporation in which information can be written onto the form directly and the form itself filed with the Secretary of State as the corporation's articles of incorporation. This form meets state requirements for incorporation, but does not contain provisions required under federal tax law to qualify the corporation as tax exempt under Section 501(c)(3) of the Internal Revenue Code. Therefore, if you plan to apply for tax-exempt status for your organization, do not use this form.

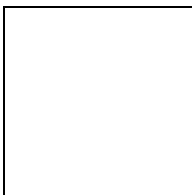
**Required Provisions.** The Act requires that articles of incorporation include the following provisions:



**Name.** The name of the corporation must be listed. See the discussion above regarding the legal requirements of a corporate name.



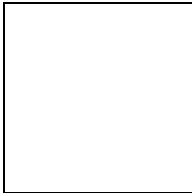
**Period of Existence.** You must list the period of duration of the corporation. The period is usually perpetual, but it may be limited to a specific number of years.



**Purpose of Organization.** You must describe the purpose or purposes of the organization. Under The Act, a nonprofit corporation may be organized for any lawful purpose, including, but not limited to, charitable,

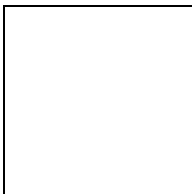
benevolent, eleemosynary, educational, civic, patriotic, political, religious, social, fraternal, literary, cultural, athletic, scientific, agricultural, horticultural, animal husbandry, and professional, commercial, industrial or trade association. The Act prohibits certain organizations from being organized under it. These include labor unions, cooperative organizations and organizations subject to any of the provisions of the banking or insurance laws of the State.

If you plan to seek tax-exempt status for your organization, you must ensure that the purposes you choose are consistent with requirements of federal tax law. A discussion of charitable and other permissible purposes for federal tax exemption appears in [Chapter II](#).



**Registered Agent and Office.** You must give the name of the initial registered agent and the address of the initial registered office. The registered agent may be: (i) an individual who is a Washington resident, or (ii) a nonprofit or for-profit corporation. If the registered agent is a corporation, it must be incorporated in Washington or, if incorporated in another state, it must be authorized to do business in Washington. The business office of the registered agent is the registered office of the nonprofit organization. It must be at a specific geographic location in Washington State. A post office box is permitted only if the geographic address of the registered office also is provided.

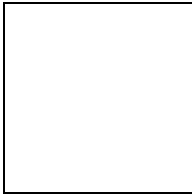
In addition, the articles of incorporation should attach or include a consent form in which the registered agent agrees to serve as registered agent of the corporation. This consent must be filed with The Secretary of State along with the articles of incorporation. An example of such consent appears at the end of the sample articles which are attached as [Exhibit A](#).



**Directors.** The board of directors serves as the governing body of the corporation and is responsible for its management and administration. The board has the ultimate responsibility of running the organization.

The Act requires that you provide the number of directors constituting the initial board of directors and the names and addresses of the persons who will serve as the initial directors. You may have one or more individuals on the initial board of directors.

The Act requires that a board of directors be composed of one or more individuals. A corporation or other entity may not serve as a director of a nonprofit corporation under The Act. The number of directors constituting the board of directors can be provided in either the articles or bylaws. Often the articles of incorporation state that the bylaws will provide the number of directors on the board, because the bylaws are more easily amended to accommodate the changes an organization may make in the number of directors on its board over time.



**Incorporators.** The incorporators are the organizers of the nonprofit corporation. They sign and file the articles of incorporation. A nonprofit corporation may have one or more incorporators. An individual or an entity may act as an incorporator. If an individual, the individual must be at least eighteen years of age. You must list the names and addresses of the incorporators of the corporation in the articles of incorporation.

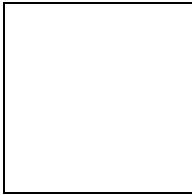
Until the corporation is formed, any incorporator may act on behalf of the organization. Such incorporator may be personally responsible for any expenses or liabilities incurred prior to the date of incorporation if the nonprofit corporation is never formed or if the acts of the incorporator are not ratified by the board of directors. Therefore, if an incorporator makes any expenditures on behalf of the organization before it is incorporated and wishes to be reimbursed by the corporation, the incorporator must keep accurate records and receipts of any and all expenses for which he or she will seek reimbursement.

Finally, an incorporator must file accurate information with the Secretary of State. If an incorporator files documents that he or she knows contain false information, the incorporator will be guilty of a gross misdemeanor.

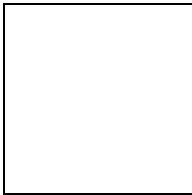
**Dissolution.** You must provide the name of any person or corporation to whom net assets are to be distributed in the event the corporation is dissolved. “Net assets” are the funds and other property remaining after payment of all the debts and other liabilities of the corporation and the appropriate distribution of charitable assets.

If your organization plans to apply for status as a tax-exempt 501(c)(3) organization, there are additional requirements that apply to this provision under federal law. Federal tax law requires that upon dissolution of a 501(c)(3) organization, any remaining assets be distributed to another 501(c)(3) organization for one or more exempt purposes. The IRS requires that this be stated in the articles of incorporation of a 501(c)(3) organization. The attached sample articles provide language that satisfies the federal requirements. See [Exhibit A](#).

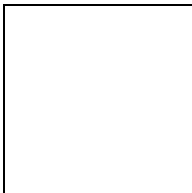
**Recommended Provisions.** Your organization may want to include one or more of the following provisions in its articles of incorporation:



**Director Liability Limitations.** This provision eliminates or limits the personal liability of directors, officers and/or members of the corporation for monetary damages for conduct as a director, officer or member. The sample provision in the attached form of articles of incorporation limits the liability of directors, officers and members to the extent permitted in Washington law. The Washington Nonprofit Corporations Act forbids eliminating or limiting liability for acts or omissions that involve intentional misconduct by a director, officer or member or a knowing violation of law by such director, officer or member or for any transaction from which the director, officer or member will personally receive a benefit of money, property or services to which such person is not legally entitled.



**Indemnification.** Under an indemnification provision, the corporation promises to pay expenses, liabilities and losses incurred by a director or officer of the corporation in defending such director or officer in any legal action in which such person becomes involved because of actions taken in the ir official capacity as a director or officer of the corporation. A nonprofit corporation may not indemnify a director or officer found by a court to be liable to the corporation. A sample indemnification provision is included in the sample form of articles of incorporation in [Exhibit A](#).



**501(c)(3) Requirements.** An organization seeking federal tax-exempt status under Section 501(c)(3) of the Code must satisfy several additional requirements in its articles. In addition to ensuring that the purposes and dissolution provisions meet federal tax law requirements, the articles must prohibit the distribution of any net earnings to members, directors, officers or other private persons and must contain appropriate language with respect to political action and lobbying activities. The form of articles attached as [Exhibit A](#) contains examples of such provisions. Again, the form articles of incorporation available through the Secretary of State's office do not contain these provisions and, therefore, should not

be used if you intend to seek 501(c)(3) status for your organization. In addition, a fuller discussion of these requirements is contained in [Chapter II](#) of this book.

### 3. Bylaws

While it is not required that bylaws be prepared prior to filing the articles of incorporation with the Secretary of State, it is recommended that bylaws be drafted at the same time as the articles ensure that the documents are consistent with each other and that the particular purposes, mission and manner of acting are reflected in both of the organization's governing documents.

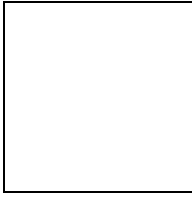
**General.** Bylaws contain the rules adopted for the regulation and management of your organization. The Act requires that the board of directors of a nonprofit corporation adopt bylaws for the corporation. Provisions in the bylaws may not be illegal or inconsistent with the articles. Bylaws are not filed with The Secretary of State, but are provided to the IRS with the application for 501(c)(3) tax-exempt status. Most bylaws outline the duties and powers of directors and officers and provide for notice, time and place of meetings. If the corporation has members, the bylaws contain rules for admission, voting rights and meetings. If the corporation requires dues, then the amount, method of calculation and payment dates may be stated in the bylaws.

**Forms Attached.** Two forms of bylaws are attached to this book to serve as a guide in developing your organization's bylaws. [Exhibit B](#) is a sample of bylaws for a corporation with members, and [Exhibit C](#) is a sample of bylaws for a corporation without members.

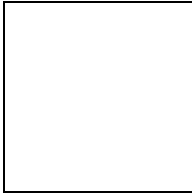
**Statutory Provisions.** Bylaws can differ greatly among nonprofit organizations, reflecting the different types of nonprofit organizations and organizations' different governing structures and styles. However, when drafting bylaws, you need to pay attention to requirements in Washington law. The Act provides rules on such topics as time and place of members' and directors' meetings, voting rights, quorum, qualifications and duties of directors and removal of directors and officers. These statutory provisions act as default provisions and will govern the corporation in the absence of such provisions in the bylaws (or articles). In addition, the Act contains certain requirements that must be met by all corporations subject to the Act. These requirements will govern over any inconsistent provisions on the same subject in the bylaws or articles. Therefore, it is recommended that organizers take care to develop bylaws that will suit the purposes, activities and governing structure of the organization and meet statutory requirements.

To assist in drafting bylaws, the following information provides a description of the provisions in the Act which will govern an organization unless otherwise specified in the organization's bylaws (or articles of incorporation). That is, these are the "fall back" or "default" provisions, which are used in the event that an organization's bylaws do not address a particular topic. For example, if your organization's bylaws do not contain a provision stating the number of members needed to call a special meeting, then the number will be the number required in the Act. Therefore, if you would like a different rule for your corporation than any of the following, you must include the rule you want in the corporation's bylaws or, in some cases, its articles.

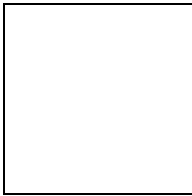
**Members.** Unless otherwise provided:



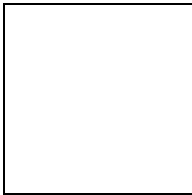
An individual, for-profit or nonprofit corporation, a general or limited partnership, an association or other entity may be a member of the organization.



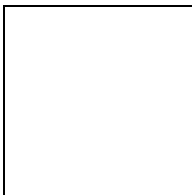
Meetings of members must be held at the registered office of the corporation in Washington State.



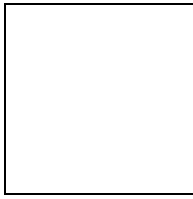
A special meeting of members may be called by members having one-twentieth of the votes entitled to be cast at such meeting.



Members of the organization may participate in a meeting of members by means of conference telephone or similar communications equipment by means of which all persons participating in the meeting can hear each other at the same time.

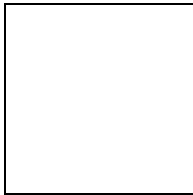


Notice of regular meetings other than the annual meeting need only be made by providing each member with the adopted schedule of regular meetings for the coming year at any time after the annual meeting and ten days prior to the next succeeding regular meeting and at any time when requested by a member.

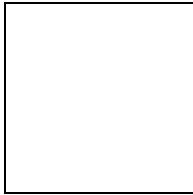


vote.

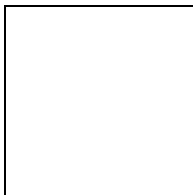
Each member has one vote on each matter submitted to members for a



Members must vote in person as opposed to by proxy.

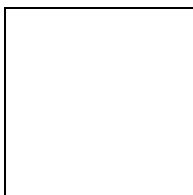


Members holding one-tenth of the votes entitled to be cast represented in person or by proxy (proxies are only permitted if provided for in the bylaws) shall constitute a quorum.



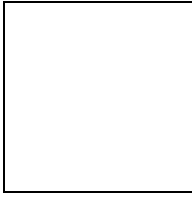
A vote of the majority of the votes entitled to be cast by members present, or represented by proxy at a meeting at which a quorum is present, shall be necessary for the adoption of any matter voted upon by the members. (Note: A greater proportion may be required by the bylaws or articles and is required by the Act for certain actions.)

**Board of Directors.** Unless otherwise specified:

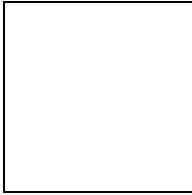


Directors need not be residents of Washington or members of the corporation.

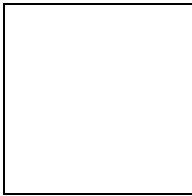




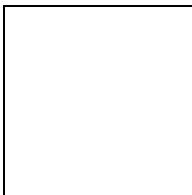
Initial directors hold office until the first annual election of directors.



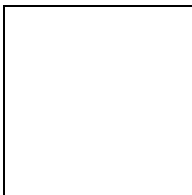
If the articles or bylaws provide for the election of any director or directors by members, then any directors elected by members may be removed, with or without cause, by two-thirds of the votes cast by members having voting rights with regard to the election of any director, represented in person or by proxy (if permitted by the bylaws) at a meeting of members at which a quorum is present. (Note: There are some special rules with respect to cumulative voting which should be reviewed if the organization is considering cumulative voting to elect directors.)



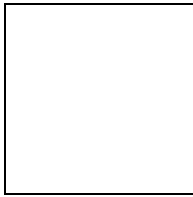
A vacancy in the board and any directorship to be filled by reason of an increase in the number of directors may be filled by the affirmative vote of a majority of the remaining directors even though less than a quorum is present.



A majority of directors constitutes a quorum. (Note: While the bylaws or articles may fix another number for a quorum, it can never be less than one-third of the number of directors.)

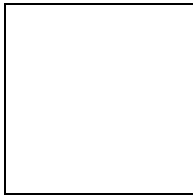


The Act of a majority of directors present at a meeting at which a quorum is present shall be The Act of the board. (Note: (1) The bylaws or articles may provide for a greater vote, and (2) The Act requires a greater vote for certain actions, such as a merger.)

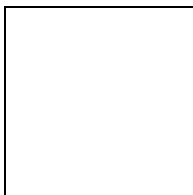


Directors may participate in board meetings by means of conference telephone or similar communications equipment by means of which all persons participating in the meeting can hear each other at the same time. (Note: This right is also permitted to committee members for committee meetings.)

**Committees.** Unless specified in the bylaws (or articles), the board does not have authority to create committees of the corporation to which it may delegate its authority to manage the corporation. In addition, the Act contains several statutory prohibitions that cannot be changed in the bylaws or articles:

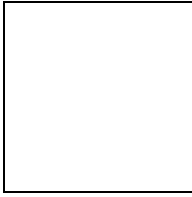


No committee shall have the authority of the board in reference to amending, altering or repealing the bylaws; electing, appointing or removing any member of any such committee or any director or officer of the corporation; amending the articles of incorporation; adopting a plan of merger or consolidation with another organization; authorizing the sale, lease, or exchange of all or substantially all of the property and assets of the corporation not in the ordinary course of business; authorizing the voluntary dissolution of the corporation or revoking proceedings therefore; adopting a plan for the distribution of the corporation's assets; or amending, altering or repealing any resolution of the board which by its terms provides that it shall not be amended, altered or repealed by such committee.

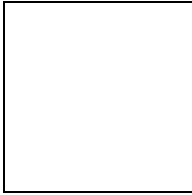


The designation or appointment of any committee and delegation to it of authority shall not operate to relieve the board or any director of any responsibility imposed by law.

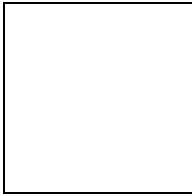
**Officers.** Unless otherwise specified:



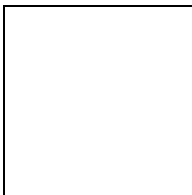
The officers of a corporation consist of a president, one or more vice-presidents, a secretary and a treasurer.



Officers are elected or appointed annually by the board.

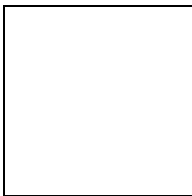


Any officer elected or appointed may be removed by the persons authorized to elect or appoint such officer whenever in their judgment the best interests of the corporation will be served thereby.

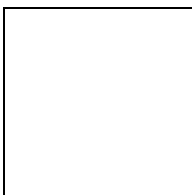


No person may hold two or more offices.

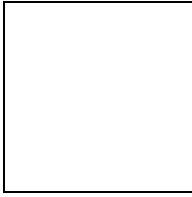
**Topics Not Specifically Covered in the Act.** The following are several of the areas for which the Act does not specifically provide and which should probably be covered in your corporation's bylaws:



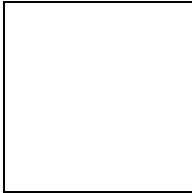
There is no procedure for the removal of directors if the organization is a non-membership corporation or does not have voting members.



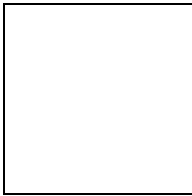
There are no required specifications for notices to directors for regular or special board meetings.



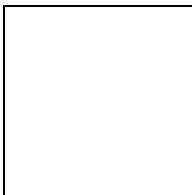
There is no requirement of an annual meeting if the organization is a non-membership corporation or does not have voting members.



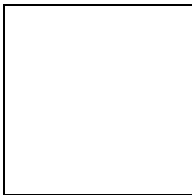
The board has no authority to create committees to which the board may delegate the authority of the board in the management of the corporation.



The creation of committees, their formation, composition and operation, are not provided for.



There is no specified manner or timing of attaining office for officers.



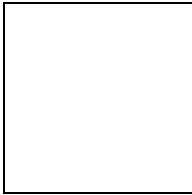
The bylaws should fix a day and time for the annual meetings of directors and members (if applicable).

#### **4. File Articles with Secretary of State**

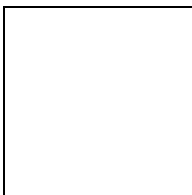
**Filing.** When the articles are completed, two duplicate originals of the articles of incorporation must be filed with the Secretary of State. Each original must be signed by all of the incorporators and the registered agent must sign the consent form. The filing fee required by the Secretary of State must accompany the articles. You may mail in documents, file them in person at The Secretary of State's office in Olympia or have a records or messenger service file them for you. If you wish to have the filing effective on the day in which the articles are delivered to the Secretary of State, you must pay an additional fee for expedited filing.

**Secretary of State's Actions.** If The Secretary of State finds that the articles of incorporation conform to law, the Secretary shall, when all fees have been paid:

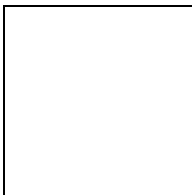
- a. Endorse on each of the duplicate originals the word “filed” and the effective day of the filing;



File one of such duplicate originals;



Issue a certificate of incorporation to which the other duplicate original shall be affixed; and



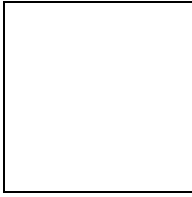
Return the certificate of incorporation and the duplicate original affixed to it to the incorporators or their representative.

**Effect of Filing.** Corporate existence of a nonprofit corporation begins upon the filing of the articles. The date stamped on the articles by The Secretary of State is the effective date of incorporation.

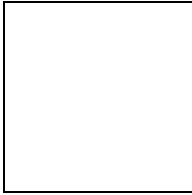
## **5. Hold Initial Organizational Meeting**

**Call and Notice of Organizational Meeting.** After the issuance of the certificate of incorporation, a majority of the initial directors of the corporation must call an organizational meeting of the board of directors by giving at least three days’ notice to the initial directors named in the articles of incorporation. The notice must state the time and place of the meeting.

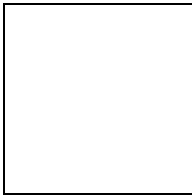
**The Organizational Meeting.** You should prepare an agenda for the organizational meeting. The initial board of directors should cover the following business items, at a minimum, at the initial organizational meeting:



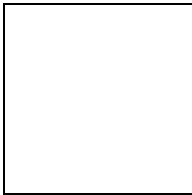
**Adopt Bylaws.** It is helpful to the initial directors and increases the efficiency of the meeting if draft bylaws are provided to the directors well in advance of the meeting for review and comment. Many groups have found it helpful to hold a study session prior to the organizational meeting to collect comments and discuss draft documents.



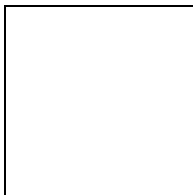
**Elect Officers.** Pursuant to Washington law, the officers of a nonprofit corporation consist of a president, one or more vice-presidents, a secretary and a treasurer. If permitted by the bylaws, the same person may hold one or more offices, except the offices of president and secretary.



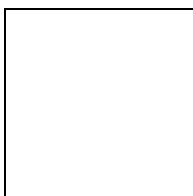
**Decide on a Fiscal Year.** Generally, this will coincide with the calendar year. Often the bylaws contain a provision designating a fiscal year.



**Select a Bank.** Choose a bank for the corporation's bank account and authorize signatories for the account. It is helpful to prepare for this in advance by obtaining forms from the bank in advance of the meeting. The board of directors must adopt a resolution authorizing the opening of the account and signatories for the account. The bank usually will have a form resolution that you can use. The organization will need a federal employer identification number, commonly abbreviated to FEIN, in order to open an account. Information with respect to obtaining an FEIN is provided below.



**Approve Any Legal Documents.** Approve initial leases and contracts, if any. Approve application for 501(c)(3) status, if prepared, and authorize execution of the form and payment of application fee.



**Ratify Organizers' Actions; Approve Reimbursement of Expenses**

Adopt a resolution ratifying all of the organizers' and/or incorporators' actions taken on behalf of the corporation prior to the date of incorporation and approve reimbursement of expenses, if any, upon review of the documentation of the expenses.

Insure that the secretary of the board or another designated individual takes notes during the meeting and prepares minutes for approval of the board. Upon approval of the board (usually received by motion adopted at the next meeting of the board), the minutes should be kept among the permanent records of the corporation.

**Unanimous Consent.** The organizational meeting can occur by unanimous written consent if necessary. Unanimous written consent is a record of the resolutions made by the board of directors and signed and dated by each director. The resolutions become effective on the date on which the last signature is obtained. A copy of the executed unanimous consent should be kept among the permanent corporate records of the corporation. A form for a unanimous written consent for the initial meeting of the board of directors is attached to this handbook as [Exhibit E](#).

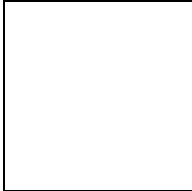
## **6. Federal Employer Identification Number**

A federal employer identification number ("FEIN") is required for the application for tax-exempt status as a 501(c)(3) organization, as well as by most banks in order to open bank accounts in the name of the corporation. The assignment of an FEIN to your corporation is a fairly straightforward process. To obtain an FEIN, IRS Form SS-4 must be completed and filed with the IRS. At the time of writing this book, the IRS permits completed forms to be filed by mail or fax. No filing fee is currently required to obtain an FEIN. If the organization has a return fax number, the IRS will fax an FEIN back to the organization.

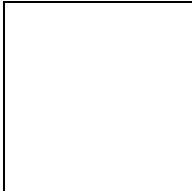
## **7. Master Business Application**

Upon the filing of the articles of incorporation with the Secretary of State, the Secretary of State's office provides a packet of information regarding new corporations in Washington State, including

a Master Business Application form. You may also obtain Master Business Application forms from the Department of Licensing. Completion and filing of the Master Business Application will provide your organization with its basic state tax registration and employer registration. Basic state tax registration (registration with the Washington Department of Revenue) is required if the organization plans to engage in any business activity. The Master Business Application form will also register the corporation for payment for certain state employment taxes. These include:



Registration with the Department of Labor and Industries and establishment of an Industrial Insurance Account; and



Registration with the Employment Security Department, for purposes of unemployment insurance.

A few nonprofit corporations are exempt from payment of unemployment insurance. A fuller discussion of the application form and requirements to pay employment taxes and other state taxes appears in [Chapter V](#) and [Chapter VI](#) of this book.



## CHAPTER II OBTAINING TAX EXEMPT STATUS FOR YOUR NONPROFIT CORPORATION

Authored by: [Sandy Deja](#), *Exempt Advisory Services*

The Federal rules governing tax-exempt organizations are complex. They cannot be completely described here. The first part of this chapter explains some of the advantages and disadvantages of becoming a 501(c)(3) tax-exempt organization, as well as some of the differences between public charities and private foundations, both of which are 501(c)(3) organizations.

The second part of this chapter is designed to help you prepare and submit to the IRS the tax exemption application for a 501(c)(3) organization.

### A. Federal Tax Exemption Law

#### 1. Why Seek Tax-Exempt Status: Advantages

##### a. Individual and Gift and Estate Tax Deduction

One of the biggest advantages of being a 501(c)(3) organization is the organization may receive contributions that also benefit the donor. A donor who contributes may be entitled to an income tax deduction, a gift and estate tax deduction, or both. There are limitations to the amount a donor can claim as an income tax deduction in any given year.

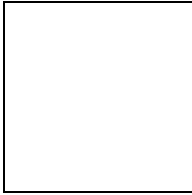
##### b. Grants from Private Foundations

Many tax-exempt organizations receive grants from a type of a 501(c)(3) organization called a private foundation. Private foundations usually distribute funds only to 501(c)(3) tax-exempt organizations that qualify as a "public charity." (Private foundation status and public charity status are discussed below.)

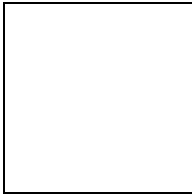
##### c. No Tax on Net Revenue

A big advantage shared by tax-exempt organizations is that no federal income tax is collected on their net revenues. Federal tax-exempt status also is necessary for certain state tax benefits. However, a federal tax (explained in [Chapter IV](#)) may be imposed on the net income of the exempt organization other than "exempt function" income. Exempt function income is income earned from activities consistent with the organization's charitable purposes. Other types of federal excise and penalty taxes may also be imposed on exempt organizations.

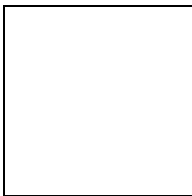
**d. Other Advantages**



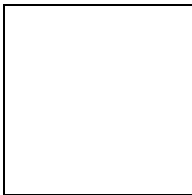
Employees of an organization may take advantage of special rules providing favorable tax treatment for contributions to retirement plans.



501(c)(3) organizations are exempt from federal unemployment tax (FUTA).



Exempt organizations qualify for preferred second or third-class mailing rate.



501(c)(3) organizations also may be exempt from the Organized Crime Control Act. The act prohibits certain gambling businesses, for example bingo games, lotteries, or similar games of chance.

**2. Restrictions on Tax-Exempt Organizations: Disadvantages**

**a. Permissible Purposes**

An organization must be formed for some charitable purpose. In fact, tax-exempt organizations are often referred to as "charitable" organizations.

The term "charitable" includes "relief of the poor and distressed or of the underprivileged; advancement of religion; advancement of education or science; erection or maintenance of public buildings, monuments, or works; lessening of the burdens of government; and the promotion of social welfare by organizations designed to accomplish any of the above purposes." These are described in more detail below.

A charitable organization must serve a public rather than a private interest. The organization must establish that it is not organized or operated for private interests such as designated individuals, the creator of his/her family, shareholders of the organization or persons controlled, directly or indirectly, by such private interests.

i. Relief of Poverty

“Charitable” includes “relief for the poor and distressed or the underprivileged.” Such organizations might:

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help poor persons find employment;

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provide employment assistance for the elderly;

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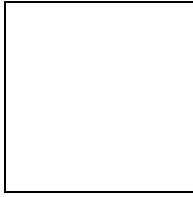
promote the rights of public housing tenants; or

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provide other social services like low income housing, meals-on-wheels, or health services.

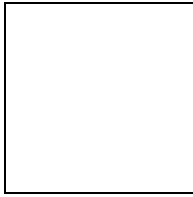
ii. Advancement of Religion

“Advancement of religion” includes:



grounds,

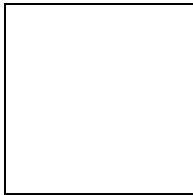
constructing or maintaining a church building, monument or burial



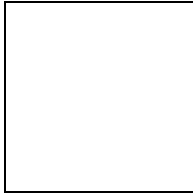
peripheral services like providing music, distributing religious literature and maintaining missions.

### iii. Advancement of Educational Services.

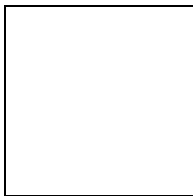
Advancement of education includes:



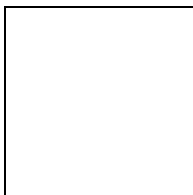
establishing or maintaining nonprofit educational institutions;



financing scholarships and other types of student assistance;



establishing or maintaining libraries and museums;



disseminating information in publications, seminars, and lectures; or

producing arts performances such as theatre, opera or dance.

iv. **Lessening the Burden of Government.**

Organizations which lessen the burden of government may:

provide legal service and training to guardians ad litem;

represent neglected or abused children in court;

work to preserve a public park or lake;

assist in operating a mass transit system;

maintain a volunteer fire department;

conserve natural resources; or

encourage plantings of trees on public lands.

v. **Community Beautification and Maintenance.**

Organizations formed to beautify and maintain the community may:

preserve a lake as a public recreational facility;

promote city beautification projects; or

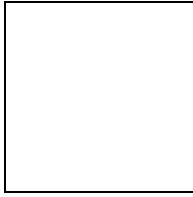
educate the public about advantages of street planning.

vi. **Promotion of Health.**

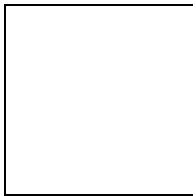
Examples include establishing hospitals or homes for the aged, and advancing medical knowledge through research.

vii. **Promotion of Social Welfare.**

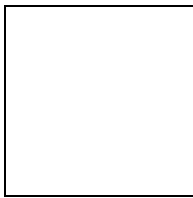
This is the most indefinite category of charitable purposes. Many types of activities are allowed. They include activities which:



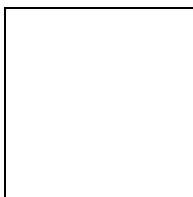
lessen neighborhood tensions;



eliminate prejudice and discrimination;



defend human and civil rights; or



combat community deterioration and juvenile delinquency.

## **b. Restrictions on Lobbying and Political Activities**

### **i. Lobbying.**

“No substantial part of the activities of a 501(c)(3) organization may constitute “carrying on propaganda, or otherwise attempting to influence legislation.” In other words, to be tax-exempt, your organization cannot spend a “substantial part” of its time or effort on lobbying. Further discussion of the restrictions and regulations regarding lobbying activities appears in [Chapter IV](#).

### **ii. Political Activities.**

In order for an exempt organization to qualify as a 501(c)(3) organization, an organization must also meet the fourth basic criteria, namely, that political activities are prohibited. The organization may "not participate in, or intervene in (including publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.

In addition to jeopardizing its tax-exempt status, a charitable organization that makes an expenditure for a "political" activity is subject to a special tax. The tax is determined by computing an amount equal to the lesser of the organization’s net investment income for the tax year involved

or the amount spent for the political activity. This amount is called "political organization taxable income" and is taxed at the highest corporate rates.

**c. Financial Limitations.**

Unrelated Business Income Tax if a charitable organization has business income from an activity unrelated to its exempt purpose, it will be taxed on this income. This tax is called "unrelated business income tax" and is discussed in further detail in [Chapter IV](#).

**d. Nondiscrimination.**

Generally, an organization should not discriminate against classes of people. However, only certain types of discrimination are strictly prohibited.

**i. Racial Discrimination.**

An institution that racially discriminates cannot qualify for tax-exempt status as a charitable organization. In 1993, the United States Supreme Court held the famous case of *Bob Jones University v. United States* that private schools which racially discriminate may not be tax-exempt and are not eligible for deductible charitable contributions.

The rule against racial discrimination applies to all entities seeking tax-exempt status, not just private educational institutions.

**ii. Sex Discrimination**

The public generally frowns upon sexual discrimination. However, the courts do not absolutely prohibit a tax-exempt organization from discriminating on the basis of gender.

**3. Public Charities and Private Foundations**

**a. General Definition of a Private Foundation**

Although both are 501(c)(3) organizations, federal law treats public charities more favorably than private foundations. Private foundations have more limitations and stricter rules to follow. For instance, private foundations are prohibited from engaging in any lobbying activities. The rules limiting a private foundation's activities are highly technical and complicated. Failure to comply with them can subject the foundation as well as the officers and directors to excise taxes and may result in the loss of tax-exempt status. If your organization is, or if you believe it may be determined to be a private foundation, you should consult a legal professional.

IRS Publication 557 has a detailed discussion of how private foundation and public charity status are determined.

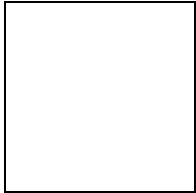


## **b. Statutory Definition of a Private Foundation**

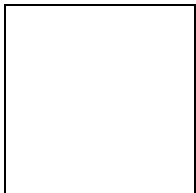
Internal Revenue Code §509 defines "private foundation" by stating not what it is, but what it is not. It says that a private foundation means a domestic or foreign organization described in §501(c)(3) other than certain types of organizations. These certain types of organizations are known as "public charities" and can be broken down into four categories. Category one: churches, schools, hospitals and medical research organizations are automatically deemed public charities. Category two: publicly supported charities. Category three: supporting organizations (tax-exempt created by or in connection with specific public charities). Category four: organizations that test for public safety.

### **i. Publicly Supported Charities**

There are two types of publicly supported charities:



Type I Publicly Supported Charity. A Type I charity “normally receives a substantial part of its support” (other than income from an exempt function) from government grants, other than 501(c)(3) public charities or from small contributions from the general public. (A small contribution is a gift in an amount less than 2% of the organization’s total support.) An organization that receives at least 10% of its total support from these sources may qualify as a public charity if it meets certain additional tests, including showing that it is attempting to increase its public support.



Type II Publicly Supported Charity. A Type II charity is similar to a Type I public charity except that it can also count certain related business income (income derived from a charitable activity) in determining whether it meets the "one-third" public support test. To obtain Type II public charity status an organization must generally receive more than one-third of its support from (1) gifts, contributions and membership fees, and (2) gross receipts from admissions, sales of merchandise, performance of services or furnishing of facilities in activities related to its exempt function, subject, however, to certain limitations. There are highly technical limitations on the amount of investment income and unrelated business income that this type of organization can receive. (Unrelated business taxable income is discussed in [Chapter IV.](#))

### **ii. Supporting Organizations**

Supporting organizations need not be publicly supported but are sufficiently related to publicly supported organizations or "public entities." A supporting organization must be directly controlled by a public charity.

### **c. Disadvantages of Private Foundation Status**

A tax-exempt organization held to be a private foundation instead of a public charity has several disadvantages. These disadvantages include:

#### **i. Excise Tax Based on Investments**

A 2% excise tax on investment income, such as interest and stock dividends.

#### **ii. Taxes on Self-Dealing**

All direct and indirect financial transactions between a private foundation and certain disqualified persons such as large contributors are prohibited.

#### **iii. Taxes on Failure to Distribute Income**

Each year a private foundation must distribute a minimum amount of its income for charitable purposes. If it does not it will be subject to an excise tax.

#### **iv. Taxes on Excess Business Holdings**

A private foundation is also subject to an excise tax if it owns more than a certain percentage of an operating business.

#### **v. Taxes on Investments that Jeopardize Charitable Purpose**

A private foundation may also be subject to an excise tax if it makes investments that jeopardize the foundation's charitable purposes. This tax provides an incentive for private foundation managers to be especially responsible when investing foundation funds.

#### **vi. Taxes on "Taxable Expenditures"**

Even though certain types of tax-exempt organizations can engage in some non-exempt activity without losing their tax-exempt status, private foundations do not have this freedom. For instance, the IRS absolutely prohibits private foundations from engaging in lobbying. Amounts spent in lobbying and other tax-exempt activities are known as "taxable expenditures" and will trigger an excise tax payable by the private foundation.

#### 4. Summary

Federal tax-exempt status under Section 501(c)(3) provides advantages; (1) tax benefits for some contributors to the organizations, (2) eligibility for certain private foundation grants, and (3) an exemption from the federal corporate income tax on most net income. However, to obtain this tax-exempt status, an organization must accept various restrictions: (1) its purpose must be charitable, (2) it cannot provide financial benefits to private individuals, (3) it cannot participate in campaigns for public office, and (4) its lobbying of legislative bodies is strictly limited.

### B. IRS Processing of Exemption Applications

#### 1. Mailing Address; Expedited Handling

The application form for recognition of tax-exempt status as a 501(c)(3) organization by the IRS is the form 1023. [Exhibit K](#) provides information on how to obtain these forms. The instructions accompanying the form contain the mailing address for the form. It is a good idea to send the form certified mail so that you are notified when the application is received.

Many applicants are interested in expedited handling. The IRS is very reluctant to consider any application out of turn, but will sometimes be persuaded by a letter from an unrelated third party, such as a grant-making agency. Because exemption applications may travel to different parts of the country depending on the IRS workload, a letter of this kind must accompany the application when it is originally submitted. To insure that a request for expedited handling is not overlooked, place it on top of all other materials sent to the IRS, and use large, bold type to call attention to the request.

#### 2. User Fee

The IRS has charged a non-refundable processing fee for exemption applications since 1987. Attach your payment to IRS Form 8718, and attach Form 8718 to the front of the Form 1023 exemption application. There is currently a two-tiered fee schedule. Organizations whose gross receipts have averaged, or will average, not more than \$10,000 per year pay \$150. Larger organizations pay \$500.

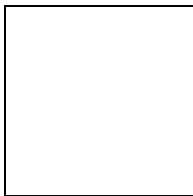
The IRS does not begin processing an application until the check for the User Fee has cleared, so you may speed up your application slightly by paying with a cashier's check or money order. If you pay by check, watch your bank statements to make sure the IRS does, in fact, cash the check for the User Fee. If the User Fee check is not promptly cashed, it is an indication that the application may have been lost in the mail. When the IRS has confirmed payment, a Form Letter 5548 is sent to the applicant. This is a brief letter acknowledging receipt of the application, and giving an estimate of how long it will take the IRS to complete processing. [Exhibit G](#) briefly describes Form Letter 5548, as well as other letters the IRS commonly uses in exemption application processing.

If you pay the lower User Fee, and the IRS challenges you on it, prepare and submit a four year financial statement or projected budget showing that gross receipts have averaged or will average less than \$10,000 each year.

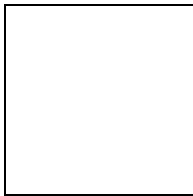
A new IRS revenue procedure announcing the User Fee comes out each January; if you are submitting your application late in the year, there may be some benefit to getting it in before January 1st.

### 3. Screening

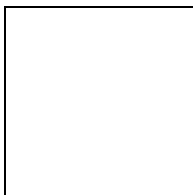
A “Screener” normally reviews exemption applications first. After checking to make sure that the application is properly signed and the required attachments are all present, this person determines whether the application can be closed without further development or correspondence with the organization. Although there are no published guidelines on this, the typical organization whose application is closed in this way has four characteristics:



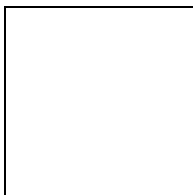
a relatively small budget;



no paid employees;



“classic” 501(c)(3) activities; and



no potential problems, such as unrelated business income or legislative activities.

An example might be a Parent Teacher Association (PTA). An application approved by the Screener may take from five to ten weeks, start to finish.

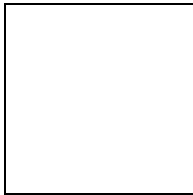
#### 4. Inquiry Letter

Applications that cannot be closed immediately by the Screener require additional development. At the time of this writing, IRS employees in offices all over the country are handling this phase of processing. Therefore, a case, which requires additional development, is likely to take 15 to 20 weeks, start to finish.

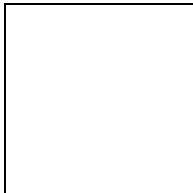
When an inquiry letter (Form Letter 1312) is sent, the applicant will normally have 21 days to respond. If additional time is needed, the agent handling the case will routinely grant an extension of ten days to two weeks. If that will not be enough time, however, the IRS usually prefers to close the case (Form Letter 1314). This type of closure is referred to as a “Failed to Furnish” or “Failed to Establish.” The file is kept available for up to a year, and reopened automatically when additional information comes in.

**Caution!** The IRS will charge a new User Fee if information is submitted more than 90 days after a case is closed using Form Letter 1314!

The questions the IRS asks most frequently are listed below:



Will any officers, directors, members, or their relatives, receive a salary, reimbursement for expenses, or any other form of payment from your organization? If so, explain fully, and include the recipients’ names, their duties, and the number of hours each week that they will devote to such duties. State the amount of compensation each will receive and the basis for arriving at the amounts of such payments.



Please supply a chronology and complete description of all activities of your organization since the date of incorporation, as well as activities planned for the next 12 months.

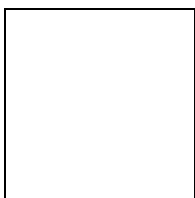
Please supply copies of literature regarding your organization including, but not limited to, newsletters, newspaper articles, brochures, pamphlets, solicitations for donations, etc.

Will anyone use your facility other than for the purpose of directly carrying out your work? Will any of your directors or employees reside at your facility? If so, explain fully. Is the owner of the facility related to you in any way other than as landlord?

Will you engage in any publishing activities (i.e., printing, publication or distribution of your own material or material printed or published by others and distributed by you) of any nature? If “yes,” submit the following: (followed by a detailed list).

Will you engage in the sale of merchandise? If “yes” submit the following: (followed by a detailed list).

Will you engage in the sale of services? If “yes” submit the following: (followed by a detailed list).



Will you engage in lectures, or seminars open to the public or to members? If “yes,” submit the following: (followed by a detailed list).

## 5. Final Disposition

Once you have answered all of the IRS agent’s questions satisfactorily, a favorable determination letter will be issued. The two form letters used most frequently for favorable 501(c)(3) determinations are Form Letter 1045 for an Advance Ruling, and Letter 947 for a Definitive Ruling. (For discussions of these two terms refer to the material under the heading, page 7, Part III, Question 11 below.)

If the IRS denies an application, they must provide a written explanation of the facts, law, and argument upon which their decision is based, as well as an explanation of your appeal rights.

## C. Assembling Your Application

### 1. Forms

**Form 1023** Application for Recognition of Exemption Under Section 501(c)(3). Make certain that all applicable parts of the form are completed, including any schedules required for your organization. An authorized person, usually the President of the Board of Directors or other officer, rather than the Executive Director, must sign the form.

**Form 8718** User Fee for Exempt Organization Determination Letter Request, complete and attach a check or money order made out to the IRS, for the applicable fee. Enter “Form 1023” and, if possible, the organization’s EIN, in the memo area of the check. If the lower fee is paid, an authorized person must sign the declaration portion of the Form.

**Form 872-C** Consent Fixing the Period of Limitation Upon Assessment of tax. Submit two copies with original signatures, if the organization is requesting an “Advance Ruling.” (See discussion under the heading Part III, Question 11 below. An authorized person must sign form 872-C.

**Form SS-4** Application for Employer Identification Number. This form is not needed if the organization has already had a federal employer ID number assigned.

**Form 5768** If the organization has decided to elect to make expenditures to influence legislation under section 501(h) of the Internal Revenue Code.

**Form 2848** If the organization will be represented, or the various IRS forms signed, by someone other than an officer or board member such as the organization’s lawyer.

## **2. Required Materials**

### **a. Articles of Incorporation**

A copy of the Articles of Incorporation must be submitted (bylaws alone are not enough). Articles of Incorporation should have the Secretary of State's stamp in the upper right hand corner of the first page. See [Exhibit A](#) for sample *Articles of Incorporation*.

### **b. Bylaws**

These should have been adopted by the Board of Directors and signed and dated.

### **c. Financial Data**

Actual financial data, including income statement(s) and a recent balance sheet, if the organization has had any financial activity should be included with the application.

### **d. Budgets**

A two-year projected budget, showing both expected sources of income and anticipated expenses is needed. (Sometimes the IRS asks for a projected budget even when the applicant can provide a full year of actual financial data.)

## **3. Optional Materials**

This is meant to be a comprehensive list. Many items may not apply.

### **a. Printed materials**

Printed materials describing the history of the organization, its activities and its plans for the future. This might include brochures, pamphlets, descriptive literature, published materials, etc.

### **b. Newsletter**

If the organization publishes a newsletter, sample copies.

### **c. Materials Prepared by Members**

If the group is a membership organization, any materials prepared for members such as, membership application forms, promotional materials, sample membership certificates or identification cards, sample copies of member-only publications, etc.

### **d. Media Materials**

If the organization has received media coverage, copies of newspaper clippings, transcripts of interviews, etc.



**e. Grants**

Any documentation available regarding grant monies. This might include grant applications, grant contracts, or correspondence between the organization and the grantor organization.

**f. Events**

If appropriate, a “schedule of events,” showing where and when the organization has held informational, performance or other events during the last 12 months. Include approximate attendance.

**g. Scholarships or Grants**

If the organization will have a scholarship or grant program:

A description of how potential applicants will hear about the program;

A description of eligibility requirements;

A sample (draft will do) of the application form(s) applicants will be required to submit;

A description of the selection process, including a description of the selection committee itself, and how members of the selection committee are chosen;

Any guidelines prepared for the selection committee's use; and

Conditions placed upon grants or scholarships, including any requirements for grade notification and a description of action that will be taken if the terms of the grant are violated.

#### **h. Correspondence Files**

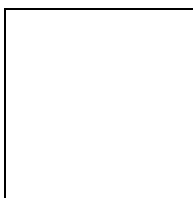
In the absence of the several kinds of printed materials described in items above, it is sometimes useful to have selected letters from the organization's correspondence files, such as letters between the organization and potential members or board members, letters of appreciation from groups to which the organization has made presentations or otherwise helped out, or perhaps even letters from public officials commenting on the organization's efforts. Include any or all of the following:

Advertisements;

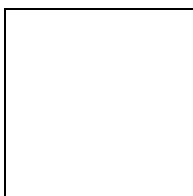
Actual samples of items the organization has for sale;

Copies of contracts, rental agreements, leases, or loan agreements involving the applicant;

Copies of Federal, State or local legislation, if any, regarding the creation or continued existence of the organization;



Resumes of board members and/or key employees, if readily available, and/or copies of licenses, certificates, etc.;



Independent appraisals of assets the organization is renting or purchasing from related parties.

**i. Other Materials**

Anything else which would give the IRS insight into the organization's mission or operations.

**D. Walk Through FORM 1023**

**1. General Concerns**

Throughout Form 1023, it may be preferable to say "Please See Attachment" or "Please see Exhibit Attached" and attach a word-processed document or spreadsheet. Inserting these in the appropriate spot within the pages of the application itself will save the IRS agent from having to search for your attachments. Be sure to label each attachment with the organization's name and FEIN number, the question number to which the attachment relates and the Exhibit number, if you are using numbered Exhibits. The comments below relate to the 9/98 revision of Form 1023.

**Page 1 - Part I, Question 2**

If your organization does not yet have an Employer ID Number, apply for this using Form SS-4. Fairly prompt service can be obtained by faxing a completed, signed, form to the IRS at (801) 620-7115 [not toll free]. Be sure to enter a "fax-back" number on the SS-4. The SS-4 can be simply attached to Form 1023, and the message "Form SS-4 attached" entered in box 2, but usually an organization needs to have Federal ID number immediately for banking or similar purposes.

**Page 1 - Part I, Question 8**

Form 990 is not required if gross receipts are less than \$25,000. If gross receipts are expected to be less than \$25,000, check the "no" box and write "Gross Receipts <\$25,000," either on an attachment or in the tiny space available.

### Page 1 - Part I, Question 9

If you have not already filed Federal income tax returns, or exempt organizations information returns, do not do so now. Filing income tax returns would be inconsistent with your claim to exempt status, and the IRS cannot process exempt organization returns until your application has been approved. If the due date for a return is near, apply for an extension.

### Page 1 - Part I, Question 10

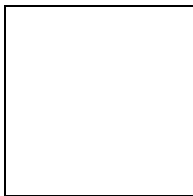
Governing documents submitted must be “conformed” copies, meaning that Articles of Incorporation must have the stamp of the state authorities, and bylaws must be signed and dated (see page 3 of the Form 1023 instructions). The primary governing instrument (usually Articles of Incorporation) must meet the IRS “Organizational Requirement.” These requirements are discussed in Section A of this Chapter. The Form of Articles of Incorporation in [Exhibit A](#) contain provisions to meet the organization’s requirement.

### Page 2 - Part II, Question 1 (Narrative)

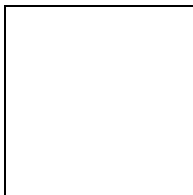
This is the heart of the application. The narrative can literally make or break the application. One approach is to start with the formula:

[Name of organization] is organized exclusively for [religious, charitable, scientific, literary or educational] (choose one or more)] purpose(s). Specifically, [Name of organization] (describe in one or two sentences what the organization does).

In succeeding paragraphs, define the problem the organization hopes to solve, using statistics if available. Try to cover WHO, WHAT, WHEN, WHERE, HOW, etc. Examples:



Who will the organization’s members, clients or patrons be? Who will carry on the activities of the organization?



What will the organization offer to these individuals or entities? What will the organization charge? What will take place at a typical meeting or event of the organization?

When did the organization's founders begin working on it? When will the organization be fully operational? When will regular meetings or events be held?

Where will the organization be based? Where will the organization obtain its funding?

How will members, clients or patrons hear about the organization's activities? How many members, clients or patrons does the organization expect to serve? How is the organization distinguishable from for-profit entities, if any, with similar activities?

If, after reading other chapters of this book, you realize that there are potential problems with your organization's exempt status, it is probably best to address these issues head on. For example, you could explain that "The organization accepts paid advertising in its newsletter and will file Form 990-T, and pay any tax due," or "Although the organization performed referral services for members in the past, this activity never constituted more than 1% of the organization's overall activities, and the board voted to discontinue this activity on [insert date]."

If at all possible, try to keep the narrative to just one page. Rather than using more than one page, end your narrative with a list of other attachments that describe the activities in greater detail, such as a mission statement, list of goals and objectives, newsletter, grant applications, etc.

### **Page 2 - Part II, Question 2**

Copy the anticipated categories of income shown on the organization's projected budget.

### **Page 3 - Part II, Question 4d**

The IRS is really trying to ask the following (1) Are any board members related (by blood or marriage) and (2) Have any board members made a donation to the organization (directly or indirectly) of \$5,000 or more?

### Page 3 - Part II, Question 6

Note that the question relates to relationships with non-501(c)(3) organizations. More often than not the answer will be “NO.”

### Page 4 - Part II, Question 9

If your organization plans to finance a project with tax-exempt bonds, you should have your application prepared by a professional with expertise in this specific area.

### Page 4 - Part II, Question 10

If the “yes” box is checked, for either part of this question, be sure to attach a copy of the organization’s lease or contract. If the organization’s budget shows rent, and the “yes” box is not checked, the IRS may want to know why.

### Page 4 - Part II, Question 11

It is not required that an organization be a membership organization to qualify for 501(c)(3) status. Many times, the only membership benefits are intangible, such as voting rights, eligibility to hold office, etc.

### Page 4 - Part II, Question 12a

**Do not say the organization’s charges are based on cost!** In the real world, of course, everyone must consider costs, but for the IRS, using cost as the basis for fees or charges is a hallmark of a for-profit organization. Instead, survey what other non-profits offering similar services charge, and base your fees on that, or set your fees at a level that most people likely to need your services can afford, or set your fees as low as you feasibly can, with the difference to be made up by donations, or establish a sliding scale for fees based on income and family size.

### Page 4 - Part II, Question 12b

If the organization limits its services, the beneficiaries should probably be members of a “charitable class,” or a segment of a charitable class. Unfortunately, this is a term which is not well defined. Roughly, a class would be children, aged, handicapped, poor, indigent, ill or unemployed.

### Page 4 - Part II, Question 13

If this question is answered “yes,” the IRS will almost surely want the organization to make the section 501(h) election. Refer to [Chapter V](#) for a discussion of the limitations on lobbying for 501(c)(3) organizations.

## Page 4 - Part II, Question 14

The only correct answer to this question is "no."

## Page 5 - Part III (15 Month Rule)

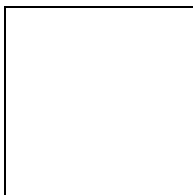
New organizations normally have up to 27 months (15 months, plus an automatic 12-month extension) to submit a Form 1023, 501(c)(3) Application, to the IRS.

The "15 Month Rule" is waived for churches, subordinate organizations covered by a group ruling, organizations created before October, 1969 (a category not listed on page 5) and small publicly supported organizations. Small public charities are not officially required to file the application as long as gross receipts continue to average less than \$5,000 per year. **CAUTION!** Do not confuse this rule with either the User Fee threshold of gross receipts <\$10,000 or the Form 990 filing threshold of gross receipts <\$25,000.

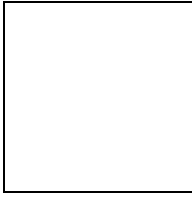
When a Form 1023 application is filed late, and no exception applies, the IRS grants 501(c)(3) status "prospectively" that is, effective beginning with the date postmarked on the application envelope. This can adversely affect both the taxes owed by the organization and deductibility by donors.

An organization that missed the 27-month deadline, and does not need retroactive 501(c)(3) status, can usually get 501(c)(4) status for prior periods. An organization that missed the 27-month deadline, and needs 501(c)(3) status for prior periods should write "FILED PURSUANT TO SECTION 301.9100-2" at the top of page 1 of Form 1023. You will have to prepare a statement as outlined in the Form 1023 instructions to explain the late filing.

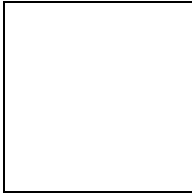
Even though churches, organizations created before October, 1969 and publicly supported organizations whose gross receipts average less than \$5,000 per year are not required to file, there are a number of reasons why such organizations might want to apply:



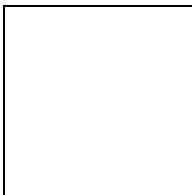
Although section 508 of the Internal Revenue Code provides deductibility of contributions for churches and small organizations, the burden of proof for tax deductibility is on the donor. A church or small organization might choose to apply for 501(c)(3) recognition to save donors possible embarrassment and inconvenience during an audit.



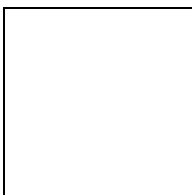
Almost every grant-making agency, public or private, requires a 501(c)(3) determination letter from grant applicants. A church or small organization might need to apply for 501(c)(3) recognition if it plans to seek grant funding.



Other State and Federal agencies, such as the Postal Service, or the Washington Gambling Commission, may require proof of exempt status before issuing permits or exemptions. Each agency has its own rules, which may not provide exceptions for churches and small organizations. Such organizations might have to apply for 501(c)(3) recognition to satisfy other governmental agencies.



Failing to apply for IRS exempt status can sometimes undermine an organization's credibility with the press or the public. A church or small organization might find that 501(c)(3) recognition is an important part of the image it wants to convey.



An organization which expects to have employees can save a small amount of payroll taxes by applying for 501(c)(3) recognition. A 501(c)(3) letter means an organization will not have to pay FUTA - Federal unemployment taxes.

NOTE: An organization which no longer qualifies for the low gross receipts exception must submit its application to the IRS within 90 days of the end of the year in which average gross receipts exceed \$5,000 if it wishes to obtain fully retroactive 501(c)(3) status.

### **Page 6 - Part III, Question 8 - Foundation Status**

When the IRS issues a favorable 501(c)(3) determination letter, it is actually two rulings in one. In addition to recognition of 501(c)(3) status, the IRS rules on "Foundation Status," a sort of



subcategory under 501(c)(3). All 501(c)(3)'s fall into one of two broad categories — public charities or private foundations.

An organization that cannot show that it qualifies for public charity status (see below) will be considered a private foundation. Generally, private foundations receive most of their support from a limited number of sources, such as one family, or one corporation, or primarily from investment income. It is generally less favorable to be a 501(c)(3) private foundation because these organizations must pay tax on income from interest, dividends, capital gains and other passive income, and are subject to a wide variety of restrictions with respect to how they invest their assets and conduct their operations. Section A of this Chapter discusses these categories in more detail.

### **Page 6 - Part III, Question 9 - Private Operating Foundation**

True “private operating foundations” are rare. An organization that believes it is a private operating foundation should probably have its application professionally prepared.

### **Page 6 - Part III, Question 10 - Reason for Public Charity Status**

Some organizations are “Public Charities” solely because of the activities they carry on:

Churches [box 10a]

Schools [box 10b]

Hospitals [box 10c]

Supporting Organizations [box 10e]

Other organizations are “Public Charities” because they receive at least 33.33% of their support from the general public. Organizations whose public support is mostly in the form of gifts or contributions are described in “Sections 509(a)(1) and 170(b)(1)(A)(vi),” and would check box 10h. Organizations whose public support is mostly in the form of payments for goods or services, such as admissions to cultural events, fees for therapy or payments at fundraising events, are described in “Section 509(a)(2),” and would check box 10i. Additional limitations for both types of public charities are discussed below under Page 7 - Part III, Question 13 and 14. Many organizations have a mixture of types of income. It is perfectly OK and very common to check box 10j and let the IRS decide for you.

### **Page 7 - Part III, Question 11 - Advance Ruling**

Organizations that are “Public Charities” because they receive at least 33.33% of their support from the general public must complete a tax year of at least eight months before they can receive a permanent public charity determination from the IRS. Because of this, many new organizations receive a temporary or “advance” ruling rather than a permanent, “definitive,” ruling.

With an Advance Ruling, the IRS rules that an organization is likely to be publicly supported, and agrees to treat the organization as a public charity for an initial five-year period. Because five years is longer than the normal IRS statute of limitations, organizations receiving an Advance Ruling must complete Form 872-C to extend the statute of limitations to cover the additional years. At the end of an Advance Ruling, the IRS will give the organization an opportunity to show that it is, in fact, publicly supported. With an Advance Ruling, the 501(c)(3) status of the organization is not in question. It is only private foundation status, a subcategory under 501(c)(3), that is still up in the air.

### **Page 7 - Part III, Question 12 - Unusual Grants**

Sections 509(a)(1)/170(b)(1)(A)(vi) and 509(a)(2) limit the amount that an organization can receive from private sources (see Questions 13 and 14 below), but also provide that certain grants that might otherwise adversely affect the organization’s public support computations can be ignored. Because the 33.33% public support tests are performed on financial data aggregated for up to five years, it is sometimes not possible to know at the time a grant is received whether it will, in fact, meet the definition of an unusual grant. If the organization has received some relatively large grants from private sources, they should be listed here.

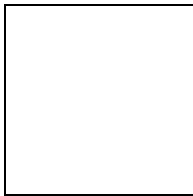
### **Page 7 - Part III, Question 13 - 509(a)(1) and 170(b)(1)(A)(vi) Limitations**

As described above, certain types of public charities must receive at least 33.33% of their support from the general public. Under sections 509(a)(1) and 170(b)(1)(A)(vi), some contributions are considered to be only partly “from the general public.” The portion of any gift, etc. from a non-public source which exceeds 2% of the organization’s total support, is considered “private” or “bad” support, and counts against an organization in making the 33.33% computation. (Gross receipts from the conduct of the exempt function are ignored under 509(a)(1)/170(b)(1)(A)(vi).)

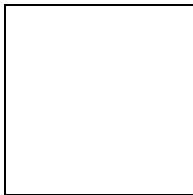
Organizations that have operated long enough to qualify for a “definitive ruling” must list these large donations so that the IRS can perform the computations.

**Page 7 - Part III, Question 14 - Sections 509(a)(2) Limitations**

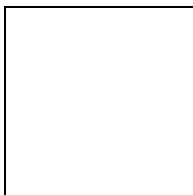
Under section 509(a)(2), not all contributions and gross receipts are “from the general public.” The following amounts are considered “private” or “bad” support, and count against an organization in making the 33.33% computation:



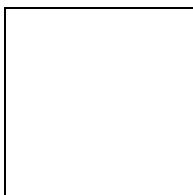
Amounts from officers, directors and trustees, certain relatives and businesses they control;



Amounts from “substantial contributors” (donors who have given more than \$5,000, if the amount given is more than 2% of the total contributions received by the organization), certain relatives of substantial contributors and businesses they control;



Amounts from individuals who control any business which is a substantial contributor; and



Gross receipts for the performance of the exempt function from any single source which exceed the greater of \$5,000 or 1% of the organization's support for the year.

Organizations that have operated long enough to qualify for a “definitive ruling” must list these amounts so that the IRS can perform the 33.33% computations.

### **Page 7 - Part III, Question 15 Additional Schedules**

Unfortunately the space considerations for this text do not allow us to deal with these additional schedules.

### **Page 8 - Part IV-A Statement of Revenue and Expenses**

The IRS usually requires both ACTUAL financial information to date, and a two-year projected budget. You are not required to use the format provided on page 8. If your organization has budget forms or treasurer's reports that it already uses, feel free to use them, as long as the information provided includes both income and expenses, and is "classified," that is, broken down by types of income and expense. Simply write "SEE ATTACHED" on page 8 and insert the organization's financial forms between pages 8 and 9 of Form 1023.

Many organizations feel it is too difficult to predict what the financial future holds. The IRS will, of course, require a projected budget even if you find it difficult to prepare.

Some organizations find it works best to start with the goals the group wants to accomplish, estimating, goal by goal, what the planned activities will cost, and then creating a strategy to come up with the necessary income. For other organizations, it makes more sense to start with projected income when budgeting. For instance, a membership group can estimate the number of people who might join, as well as the amount of due members might be willing to pay, and then decide how much of the available money will be spent on each of the organization's planned programs.

### **Page 9 - Part IV-B Balance Sheet**

The Statement of Revenue and Expenses is a summary of the organization's financial activity over a period of time, while the Balance Sheet is a "snapshot" of what the organization owns and owes on a particular given date. The IRS prefers that organizations use the last day of a month for the Balance Sheet. As with the Page 8 financial statements, an attachment is acceptable.

## CHAPTER III MAINTAINING YOUR NONPROFIT CORPORATION

### A. The Importance of Acting Like a Corporation

Sections A, B, and C Authored by: [Stephen Katz](#), *Attorney at Law*

#### 1. Limited Liability

A nonprofit corporation is a separate legal entity distinct from that of its directors, officers and employees. As such, liabilities and obligations incurred by the corporation, in the absence of unusual circumstances, must be satisfied out of the assets of the corporation and do not “pass through” to its directors, officers or employees. Put another way, a corporation’s directors, officers and employees generally have “limited liability” with regard to the liabilities and obligations incurred by the corporation.

#### 2. Personal Liability

In certain circumstances, however, a corporation’s officers, directors or members may become personally liable for the corporation’s liabilities and obligations. This “pass through” of liability occurs when a corporation’s officers, directors or members fail to maintain the corporation’s separate legal identity by confusing their individual identity with that of the corporation. This confusion of identities generally occurs when the directors, officers or members of the corporation mix their personal, individual business with the corporation’s business. In such cases, a court may choose to disregard the corporate entity created and hold the individuals acting on behalf of the corporation (i.e. the directors, officers or members) personally responsible for the corporation’s liabilities and obligations. A court may choose to impose personal liability in this manner even though articles of incorporation creating a corporation have been filed, which, as stated above, generally limits an individual’s liability.

Courts and the Internal Revenue Service (“IRS”) tend to give particular scrutiny to cases involving a small number of individuals who fill multiple roles within the corporation. In deciding whether to hold the individuals personally liable for the corporation’s obligations, courts and the IRS scrutinize the corporation and its operation to decide if the corporation meets certain minimum standards to be considered a separate entity. For instance, courts examine whether the corporation has adequate funds to pay its creditors, whether the individuals commingled corporate and personal funds on a regular basis, whether the individuals failed to keep proper corporate records and whether the corporation generally failed to act like a corporation. The IRS may assess taxes and penalties personally against the corporation’s principals if it concludes the corporation is not a valid, separate entity. Therefore, nonprofit corporations should fastidiously hold regular meetings for both the board of directors and members (if it is a membership organization). It should also prepare and place written minutes of these meetings in the corporate record book. Nonprofit corporations

should also be especially diligent in maintaining sufficient funds to pay their debts and in segregating corporate funds from the personal funds of the corporation's principals. A failure to segregate funds could also result in loss of tax-exempt status. See the discussion in the next chapter on private inurement.

A principal of a corporation (usually is an officer or director) may also become personally liable for the liabilities of the corporation if the principal fails to make clear to persons with whom the principal is dealing that he or she is in fact acting as an agent of the corporation and not individually. All business transactions of a corporation should clearly indicate that they are corporate, not individual, transactions, and the representative capacity of the officers or directors acting on behalf of the corporation should always be disclosed.

## **B. The Function, Authority and Election of Directors and Officers**

### **1. Directors**

#### **a. General**

Under the Washington Nonprofit Corporation Act (the "Act"), corporation's board of directors is the governing body of the corporation and is responsible for management and administration of the corporation. The board may delegate certain of its responsibilities to committees and officers of the corporation, but the board bears ultimate responsibility for running the corporation. A corporation exercises its powers through resolutions and acts of the board. Generally, the board delegates the day-to-day responsibilities of operating the corporation to employees and/or officers.

#### **b. Election, Number and Term**

A corporation's board of directors must be composed of at least one individual. The corporation's articles of incorporation or bylaws sets the number of and election method of the directors. The number of directors may be a range (e.g., not less than 5 or more than 15) and may be increased or decreased by amending the document setting the number. A decrease in directors cannot shorten the term of any incumbent director. The articles or bylaws may provide that directors be elected by the corporation's members or by the corporation's directors, or in some circumstances, directors may be appointed. The articles or bylaws may also provide that a certain officer of the corporation automatically becomes a director when he or she becomes an officer.

The articles or bylaws also provide for the directors' term of office. Terms can be for one year or several. Typically, a nonprofit organization chooses terms of two or three years for its directors. Each director holds office until his or her successor has been selected and qualified. The term of the directors may be staggered by providing that only some portion of the board seats are up for election at the same time. Staggering the directors' terms thus provides continuity on the board.

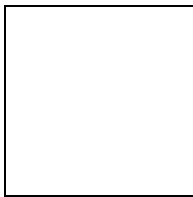
If the corporation has voting members, the articles or bylaws may require that directors be elected by a majority vote of the corporation's members. Alternatively, the articles or bylaws may provide

for a more complex manner of electing directors known as “cumulative voting.” Cumulative voting permits each member or director entitled to vote to add all of the votes to which he or she is entitled and apply them toward one candidate’s election or distribute the votes among several candidates. Under cumulative voting, each member or director is entitled to one vote multiplied by the number of directors to be elected. Cumulative voting affords members or directors who are in a minority position the opportunity to elect one director, which they would not otherwise have if director election were based solely on a majority vote.

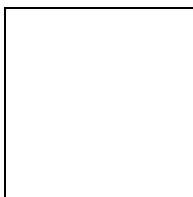
A nonprofit corporation should choose its directors carefully, considering the talents of each individual and the needs of the corporation. For example, a corporation may want to have an attorney, an accountant, or a person with fundraising expertise on its board of directors. Similarly, a corporation may want on its board a person with access to funds or a person who has special knowledge or expertise in the service area of the corporation.

### **c. Removal**

A corporation’s bylaws or articles should contain a procedure for removing directors. If the bylaws or articles provide for the election of any directors by members, and if the articles or bylaws fail to specify a procedure for the removal of directors, the Act sets the following procedure:



At a meeting where a quorum is present; or



If a corporation has cumulative voting, then a director may be removed if the number of votes cast for removal would have elected the director at an election.

### **d. Vacancies**

If the articles or bylaws do not specify a procedure to fill a vacancy on the board, then a majority of the remaining directors may elect a new director. The new director that is elected or appointed completes the unexpired term of the vacant position.

### **e. Quorum**

To be a valid act of the corporation, an act of the board must be approved by majority of the directors at a meeting in which a quorum is present. Unless the corporation’s articles or bylaws

state otherwise, a majority of the directors constitutes a quorum. A quorum may not be less than one-third of the total number of directors. The articles or bylaws may require a greater number of votes for certain important acts by the board, such as the disposition of large percentage of corporate funds or modification of the corporation's purpose.

**f. Director's Right to Dissent or Abstain**

A director may vote against (i.e., dissent) or not vote on (i.e., abstain) an action by the board. However, if the director is present at the meeting where the action is taken, it is assumed that the director assented to the action unless the director's dissent or abstention is recorded in the minutes or filed in writing with the Secretary of the corporation.

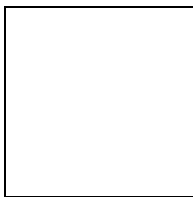
**g. Proxy Voting**

An individual serving on the board of a nonprofit corporation does so as a personal commitment. Directors of nonprofit corporations cannot appear by proxy or give their proxy to another director. Nonprofit directors must be present to listen to the discussion, consider each resolution, and act based upon their judgment.

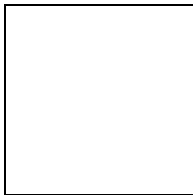
**h. Committees**

The board may designate and appoint committees to perform certain activities of the corporation, if the articles or bylaws allow the creation of such committees. However, even if the board appoints a committee and delegates certain of its duties to the committee, the board and individual directors remain ultimately responsible for duties imposed by law.

The Act prohibits the Board from delegating certain powers or responsibilities to committees. Committees cannot:



Amend, alter or repeal the corporation's articles or bylaws;



Elect, appoint or remove any member of the committee, nor any director or officer of the corporation;



Adopt a plan of merger with another corporation;

Authorize the sale, lease, or exchange of substantially all of the corporation's assets;

Authorize the dissolution of the corporation;

Adopt a plan for distribution of corporation's assets; or

Amend, alter or repeal any board resolution which by its terms may not be amended, altered or repealed by a committee.

#### i. Meetings

The board should meet regularly. The bylaws may permit regularly scheduled board meetings to be held without notice. Board meetings may be held in or out of state.

Nonprofit corporations should hold at least an annual meeting of the members, if any, and the directors. The annual meeting of the membership is typically held for the purpose of electing directors for the next year and for discussion of general business matters. The annual meeting of directors is held for the purpose of electing directors (unless directors are elected by members),

electing or appointing officers for the next year, adopting the corporation's budget, approving programs/activities and discussing future activities.

Special meetings require that notice be sent to the directors. The procedure and timing for giving notice should be stated in the bylaws. If a director attends a meeting, the director waives the notice requirement, unless he or she attends the meeting solely to object to lack of notice. The bylaws should state whether notice is required to specify the business to be conducted at such special meeting.

Regular and special meetings may be conducted by conference calls or similar methods of communication that allow comment and response by all directors at the same time. If all directors sign a written consent to a corporate action, a meeting is not required to validate the action. Note that the Act does not currently permit "on-line" meetings of any kind.

## **2. Officers**

### **a. Designation of Officers**

Under the Act, officers of a corporation are the president, one or more vice-presidents, a secretary and a treasurer. The articles and bylaws may provide for the time and manner of the election or appointment of the officers; otherwise, the officers are elected or appointed annually by the board. The articles or bylaws may allow any two or more offices to be held by the same person except for the offices of president and secretary.

### **b. Duties**

Generally, the articles or bylaws list the duties and responsibilities of the officers.

## **C. The Duties and Obligations of Directors and Officers**

### **1. Generally**

An individual's decision to become a director or an officer of a nonprofit corporation is a serious one. While many of the responsibilities of a board member or an officer are similar to those of a for-profit corporation, some duties and liabilities are unique to nonprofit corporations.

The board of directors of a nonprofit corporation is usually comprised of outsiders who do not participate in the daily operation of the organization. The board does not have direct access to information about the organization's operations and must rely upon information filtered through organization employees. As such, the board must be careful to evaluate this information to make sure that problems or potential liabilities are not being withheld from or misrepresented to the board.

The board of directors functions as a group. A director cannot speak on behalf of the board or act for the board outside of a meeting, unless authorized by the board as a whole. Any director attempting to act on behalf of the board without explicit authorization is exceeding his or her authority. However, officers and some committee chairs may have implicit authority to perform the routine tasks associated with their jobs.

## **2. The Standard of Care for Directors**

A director of a nonprofit corporation should take seriously the responsibility of managing the affairs of the corporation. The Act imposes a certain “standard of care” on directors performing this responsibility. The Act requires a director to perform his or her duties as a member of the board and as a committee member “in good faith, in a manner such director believes to be in the best interests of the corporation and with such care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstance.” This standard has several parts to it and each is discussed in turn below.

### **a. Good Faith**

First, directors must act in good faith. Often, good faith depends upon the personal intent of the director in question. It is therefore very important that when directors make a decision, especially a controversial one, they do so with proper written documentation showing that they acted with good intentions.

### **b. Best Interest of the Corporation**

Second, directors must act in the best interest of the Corporation. Directors have a special fiduciary relationship with the corporation and have the duty to act for the benefit of the organization, not for their own personal benefit.

### **c. Due Care**

Third, directors must act with due care. As a fiduciary, the board is entrusted with other people’s money and must be careful with the use of those funds. Each director must evaluate existing programs to determine if they are run efficiently and examine financial statements to ensure the corporation has adequate funds to pay its debts and that those funds are being used to further the organization’s goals and mission. The Act does not require directors to attend board meetings. However, directors who are frequently absent from meetings are not fulfilling their fiduciary duty and risk violating the duty of care. Some organizations are so concerned about absenteeism that they include a provision in their bylaws that a director who is absent a certain number of times shall be deemed to have resigned from the board.

#### **d. Prudent Person**

Fourth, each director must act as an ordinary prudent person. Directors are laypersons who are expected to use common sense and practical judgment, not be experts in every matter the board considers. However, if a board member has a particular expertise, e.g. accountant, then this person will be expected to utilize this greater knowledge and be held to this standard in his or her conduct.

The Act acknowledges that board members are not expected to be an expert in every issue that comes before the Board. In performing his or her duties, a director may rely upon information, opinions, reports or statements, including financial statements and other financial data, prepared or presented by: (a) an officer or employee of the corporation whom the director believes to be competent and reliable in the matter presented; (b) professionals or experts such as attorneys, public accountants or others, if the matter is within that person's expertise; or (c) a committee on which the director does not serve, if the matters are within the committee's designated authority. The director must always act in good faith, and make reasonable inquiry when the need is indicated by the circumstances.

### **3. The Fiduciary Duty of Directors and Officers**

Both directors and officers of the corporation have a fiduciary relationship with the corporation that demands that they at all times serve the best interests of the corporation rather than their own personal financial interests. Consequently, certain actions by directors and officers are prohibited. First, directors and officers are prohibited from entering into any transaction that involves any flow or transfer of income or assets through or away from the corporation for the benefit of anyone associated with the corporation. This prohibition includes the sale, exchange or leasing of property between the corporation and a director or officer; as well as the transfer to or the use by or for the benefit of a director or officer of corporation's income or assets. Additionally, the Act prohibits the corporation from lending money or credit to any of its officers or directors. Any director or officer engaging in such a transaction and any director or officer participating in the making of such a loan or extension of credit is liable to the corporation for the amount of the loan until it is paid.

This fiduciary duty directors owe the corporation also prohibits any conflict of interest arising from a situation where a director or such director's family member benefits from the director's position on the board, financial or otherwise. While some situations may seem innocent or fair, any conflict of interest should be avoided, because it represents a potential breach of the duty the director owes the corporation. In the event that a conflict of interest cannot be avoided, the conflict should be disclosed to the Board and the director should abstain from the discussion and the vote.

### **4. Liability of Directors and Officers to Outside Parties**

Directors and officers have potential liability to persons outside the corporation. The Act provides that a board member or officer is individually liable for any discretionary decision or failure to make a discretionary decision within his or her official capacity as director or officer if the decision or failure to decide constitutes gross negligence.

## **D. Directors and Officers Risk and Obligation**

Section D was authored by Mark Hugh, *Clark Nuber, P.S.*

### **1. Directors' and Officers' Exposure**

A director or officer is not automatically liable simply because the corporation is sued. Rather, liability arises because the director or officer is charged with some breach of a duty owed either to the corporation or to a specific party. Suits against directors or officers typically are brought in one of three ways:

An outside party may sue a director or an officer directly, claiming some injury by the corporation.

A party may assert some right of the corporation against the director or officer, suing to enforce the right of the corporation. This type of suit is referred to as a “derivative action.” In effect, the corporation is suing the director or officer to enforce the corporation’s rights, typically because of an alleged breach of the director’s or officer’s duty of care or duty of loyalty to the corporation.

The director or officer may be held independently liable under various statutory provisions concerning issues such as employment practice claims, environmental claims, tax delinquencies or antitrust claims.

Another source of possible liability arises in the context of corporate loans. Washington law prohibits nonprofit corporations from making loans to directors or officers. Any director who votes for or assents to such a loan and any officer who participates in making such a loan will be jointly and severally liable to the corporation for the loan amount until the loan is repaid.

### **2. Protection Against Risk**

#### **a. Indemnification**

Directors and officers of a nonprofit corporation typically will want the corporation to have a program of indemnification to the maximum extent permitted by applicable law. In Washington, a nonprofit corporation may indemnify its officers and directors to the same extent that a for-profit corporation can.

#### **b. Discretionary vs. Mandatory Indemnification**

A corporation may indemnify its directors and officers whether or not they successfully defend against a suit, so long as the director or officer acted in good faith and reasonably believed that actions taken on behalf of the corporation were in the corporation’s best interest, and that any other actions (i.e. actions taken in their individual capacities) were not opposed to the corporation’s interests.

In a criminal proceeding, indemnification is allowed only if the director or officer had no reasonable cause to believe the conduct was illegal.

A corporation may not indemnify directors or officers if the director or officer is found to be liable to the corporation or if the director or officer received an improper personal benefit.

### **c. Advance of Expenses**

A nonprofit corporation may pay for or reimburse the reasonable expenses incurred by a director or officer who is a party to proceeding in advance of the final settlement of the proceeding if:

The director or officer states in writing that they acted in good faith and reasonably believed that her conduct was in the corporation's best interests; and

The director or officer states in writing that they will repay the advance if it ultimately is determined that they did not meet the standard of conduct described above.

The corporation must authorize advance of expenses by either a provision in the articles of incorporation or bylaws or by resolution adopted by the board of directors.

### **d. Reporting Requirement**

If a corporation indemnifies or pays the expenses of a director's or officer's defense against liability, the corporation must provide a written report to its members (if any) before the next members' meeting. Note: This provision only applies if a corporation has "members."

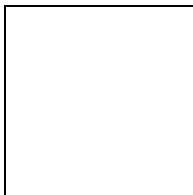
## **3. Directors and Officers Insurance**

A nonprofit corporation may purchase liability insurance on behalf of its directors and officers to cover certain claims. A director's and officer's insurance policy ("D&O insurance") may cover against liability asserted against or incurred by a director or officer whether or not the corporation would have power to indemnify the individual against the same liability.

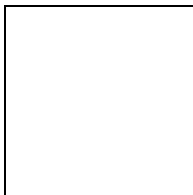
Directors and officers often will want a nonprofit corporation to provide D&O insurance coverage even if the corporation has expansive indemnification provisions in its articles of incorporation or bylaws.

D & O insurance policies typically are divided into two parts: (1) the first part typically covers reimbursement of individual directors and officers for losses for which they are not indemnified by the corporation; and (2) the second part typically provides reimbursement to the corporation for amounts that it has paid or is required to pay in indemnifying its directors and officers.

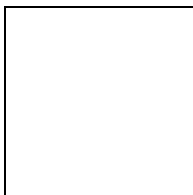
The type of coverage, deductibles, co-insurance levels, exclusions and other aspects of D&O insurance may vary significantly from policy to policy. The committee examining insurance issues should scrutinize them carefully, or possibly contact an insurance consultant or legal counsel. Virtually all D&O insurance policies have substantial exclusions that should be understood. The following liabilities often are excluded from D&O policies:



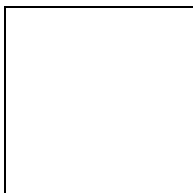
Losses covered by other insurance;



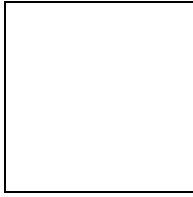
Miscellaneous exposures such as sickness or death resulting from  
pollution;



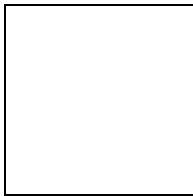
ERISA claims;



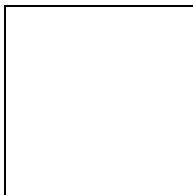
Fair employment claims;



Libel or slander actions;



Liabilities arising from intentional conduct, including fraud, dishonesty and criminal conduct;



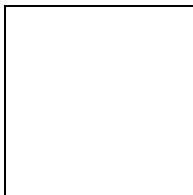
Fines, penalties or punitive damages.

Other than exclusions for intentional conduct, many exclusions may be deleted by negotiation with an insurance carrier and payment of a separate premium. A proposed D&O insurance policy also should be analyzed to determine whether the duty to defend and the cost of defense are covered by the policy.

#### **4. Statutory Protections**

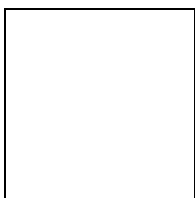
##### **a. Limitation on Liability of Directors**

A corporation's articles of incorporation or bylaws may contain certain provisions that eliminate or limit the personal liability of a director to the corporation. Such provisions, however, may not eliminate or limit the liability of a director for acts or omissions that involve

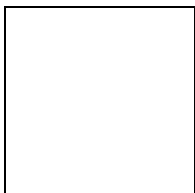


Intentional misconduct by a director, or





A knowing violation of law by a director, or



Any transaction from which the director will personally receive a benefit in money, property or services to which the director is not legally entitled.

Limiting a director's personal liability is discretionary on the part of the corporation, and if incorporated into an organization's articles, applies only to directors' liability. There is no similar provision for officers.

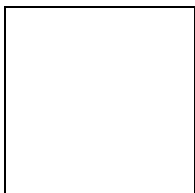
#### **b. Special Immunity**

Both officers and directors of nonprofit corporations are afforded some protection against personal liability under Washington's special immunities law. A director or officer of a nonprofit corporation is not individually liable for any discretionary decision or failure to make a discretionary decision within his or her official capacity as a director or officer unless the decision or failure to decide constitutes gross negligence.

#### **c. Volunteer Protection Act**

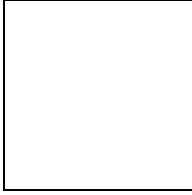
A federal statute entitled the Volunteer Protection Act of 1997 (the "Volunteer Act") also may provide some protection to directors and officers of nonprofit corporations. This statute, which took effect in September 1997, provides immunity from personal liability to volunteers, including unpaid directors and officers, working for nonprofit organizations for acts or omissions within the scope of their assigned responsibilities.

To qualify for protection under the Volunteer Act, certain criteria must be met:

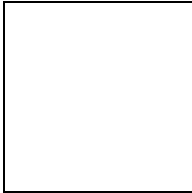


A person seeking protection under the Volunteer Act must be a "volunteer." The Volunteer Act defines a volunteer as a person who provides services to a nonprofit organization but does not receive compensation or any thing of value in excess of \$500 per year for his or her services. Thus, if a nonprofit corporation's directors or officers receive compensation for their services, the Act's

protection will not apply. A director or officer may, however, receive reimbursement of his or her expenses.

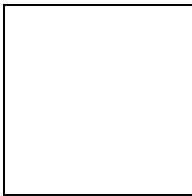


The volunteer must have been acting within the scope of his or her responsibilities for the organization at the time the harm took place. In other words, the officer or director must have been acting in his or her capacity as an officer or director of the corporation, rather than in some other capacity, such as a volunteering at a fundraising event.

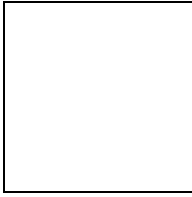


The officer or director must show that the harm in question was not caused by her willful or criminal misconduct, gross negligence, reckless misconduct or a conscious, flagrant indifference to the rights or safety of others. Although these terms are all legal terms with specific meanings under Washington law, generally, merely being careless or inattentive is not considered willful, gross or reckless conduct.

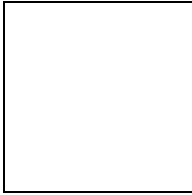
There are several important things that the Volunteer Act does not do:



Perhaps most importantly, the Volunteer Act does not prevent individuals acting as volunteers from being sued or being named in a lawsuit. Instead, the Volunteer Act provides an affirmative defense to liability, which lawyers for the volunteer would raise in the course of the litigation. Although a volunteer might be named as a defendant in the initial stages of the case, it is very likely that the claims would be dismissed fairly early in the process, assuming all of the criteria of the Volunteer Act are satisfied.



The Volunteer Act does not protect the nonprofit organization itself from liability for harms suffered in the course of its activities. The organization may be held responsible for the acts or omissions of the persons working for it, even if the persons cannot be held individually liable.



The Volunteer Act does not prevent nonprofit organizations from suing their volunteers for misconduct. Thus, if an officer or director harms the organization in some way, the organization still can bring suit against such officer or director without invoking the protection provided by the Volunteer Act.

## E. Amending Bylaws

Section E Authored by: [Judith Andrews](#), *Gottlieb, Fisher & Andrews, PLLC*

[Chapter I](#) discusses the preparation and adoption of bylaws by a new nonprofit corporation.

The bylaws may be amended pursuant to the procedure set forth in the document or in the articles of incorporation. Generally, amendments to the bylaws are effective with board approval alone. In addition to amending the bylaws, the board may also repeal one or more of the bylaws or adopt new bylaws. Once adopted, the bylaws continue to govern the affairs of the corporation until the bylaws are either amended or repealed.

## **F. Annual Report**

**Section F and G Authored by: [Stephen Katz](#), Attorney at Law**

Each year, the Washington Secretary of State sends an annual corporate report form to every nonprofit corporation. The corporation must return the report with the required fee to the Secretary of State by the due date to preserve its corporate status. Generally, the Secretary of State sends the report to the corporation's registered office at least thirty (30) days prior to the required filing date. The report requests a list of the corporation's officers and directors, any change to the address of the corporation's registered office or agent and other basic information. A corporation's failure to file the report within the required time period results in automatic dissolution of the corporation by the Secretary of State.

## **G. Corporate Records**

### **1. The Corporate Record Book**

Each nonprofit organization should keep a corporate record book of all its organizational documents. These documents include the articles, bylaws, any amendments to the articles or bylaws, minutes of all board and committee meetings, waiver of notice or notice of all meetings, tax exemption application and determination letters, annual reports, membership certificates, all insurance policies, warranties, contracts, leases and other legal documents, and copies of all communications with board members, officers, members and contributors. Corporate records should be kept at the principal office of the corporation.

### **2. Public Documents**

Certain corporate documents are part of the public record. In Washington, all public corporate records are kept in Olympia by the Corporations Division of the Secretary of State. The public corporate documents include the articles of incorporation and any amendments, articles of merger or consolidation, articles of dissolution, the name and address of the corporation's registered office and registered agent, the corporate annual report forms which disclose the names and addresses of the corporation's directors and officers, and certain other information such as the Unified Business Identifier (UBI), the license expiration date, the type of corporation (nonprofit), and, with respect to corporations and incorporated in other states which are qualified to do business in Washington, their state of incorporation.

**Chapter IV** discusses which corporate records are subject to disclosure under federal law.

## **H. Registering Trade Names and Trademarks**

**Section H Authored by:** [Bruce Goto](#), *Riddell Williams*

### **1. Introduction**

This section provides a brief and simplified description of how a nonprofit corporation might obtain and register a trade name and trademark in an independent and relatively inexpensive manner. However, this section does not address all of the potential issues that may be implicated in registering a trade name or trademark. Accordingly, the author recommends that any nonprofit corporation contemplating registering a trade name or trademark consult a knowledgeable attorney.

### **2. Trade Names, Trademarks and Service Marks**

#### **a. Trade Names**

A trade name is any word or name used to identify a business which does not include the real name of all the persons conducting the business, or which does include words which suggest additional parties of interest (such as ABC Company or ABC & Associates).

#### **b. Trademarks and Service Marks**

A trademark is any word, name, phrase, logo, color, shape, design or other feature of a good which identifies the source of origin for such good. Similarly, a service mark is like a trademark except that a service mark identifies the source of origin of a particular service rather than a particular good. For ease of discussion, any reference to trademarks in this chapter will mean both trademarks and service marks.

A company's trade name is usually also a trademark. A particular company may have many trademarks; for example, McDonald's has a trade name and trademark in "McDonald's" as well as trademarks such as "Big Mac" and "McNuggets." In the case of most nonprofit corporations, however, the corporation's trade name will usually be its most important trademark.

### **3. Conducting a Trademark Search**

#### **a. Selecting a Name**

A trademark search usually begins with a nonprofit corporation selecting a proposed name for its business or organization. In selecting a name, nonprofit corporations should strongly consider choosing an arbitrary or fanciful name to decrease the likelihood that their preferred name will be already taken and to avert potential problems with other entities who may be using similar names. Nonprofit corporations should also avoid becoming too "attached" to one name without searching

for whether that name is currently being used and should always have alternative names in mind if needed.

### **b. Conducting an Informal Search**

Before using the name it desires for its organization or business, a nonprofit corporation should conduct a search to determine if the name is already in use. This search can be done while the nonprofit corporation's articles of incorporation are being prepared, and the eventual name chosen can be inserted prior to the articles of incorporation being filed. Informal and inexpensive preliminary searches may be conducted independent of formal full searches by using the Internet or other information available at local libraries.

Initially, a nonprofit corporation might go to the U.S. Patent and Trademark Office's searchable database at <http://www.uspto.gov/tmdb/index.html> to see if a particular trademark has already been applied for or registered. If not, additional searches might be done on *Yahoo!* or other Internet search engines to see if an entity with such name already exists. Local or university libraries may also have such information available.

In general, a nonprofit corporation should avoid a name that is similar to the name or trademark of an existing entity that is in a similar business, such that it is likely that consumers will be confused into thinking the nonprofit corporation and such entity are the same or related. More information on this subject can be found at the website listed in the previous paragraph or at the website of one of the vendors at <http://www.thomson-thomson.com/>.

It should be emphasized, however, that the analysis of whether a nonprofit corporation's proposed name may have potential problems is an art rather than a science and requires experience in this area. *A nonprofit corporation may have a problem even if its name is not identical to another entity and even if the nonprofit corporation successfully registers a Washington State trade name and a Washington State trademark.* Thus, the author highly recommends that an experienced attorney assist the corporation with this analysis.

### **c. Conducting a Formal Search**

After identifying a few names through an informal search that are not in use by another business or organization (or, in the event you do not want to undertake your own informal efforts), a nonprofit corporation should strongly consider having an experienced attorney obtain and analyze one or more searches of its proposed name. The cost of searching the databases of the federal and state trademark offices is usually less than \$200. If that search is clear, to obtain and analyze a full search that also includes other databases such as company names and telephone books can be less than \$600.

#### **d. Consequences of Not Performing a Search**

Nonprofit corporations should bear in mind that if it begins using a name without conducting a search, and later finds that there is another entity with senior rights in the name, the nonprofit corporation may have to change its name, reprint stationery, change signage or incur other expenses.

### **4. Registering a Trade Name**

Once an acceptable name has been selected, a nonprofit corporation should file its articles of incorporation. As discussed in [Chapter I, Section C.7](#), a Washington Master Business Application must also be filed. Regardless of whether or not the applicable rules require registration of the nonprofit corporation's trade name, the Master Business Application should also be used to register the nonprofit corporation's trade name, because registration by this method is inexpensive and can be done simultaneously with filing the other information initially required by the Master Application. In many cases, the nonprofit corporation's trade name may be the same as its corporate name. In some cases, the acronym of a nonprofit corporation's corporate name may also be an additional trade name. For example, the acronym "ACLU" may be an additional trade name for the American Civil Liberties Union.

### **5. Registering a Trademark**

#### **a. Generally**

Applicable law permits nonprofit corporations to accrue rights in a trademark as soon as the trademark is "properly used." "Proper use" usually requires that the trademark be used in commerce in connection with the nonprofit corporation's business. For example, the trademark might be used on circulated pamphlets, in connection with submitted grant proposals, or in seminar or conference materials.

However, additional protection can be obtained, and is usually desirable, by registering the trademark under state and/or federal laws.

#### **b. State Registration**

A nonprofit corporation may register a Washington State trademark by submitting an application to the Washington Secretary of State along with appropriate fee. A copy of the application for state registration can be obtained from the Secretary of State's Office. The Washington Secretary of State generally issues the trademark registration within one month after submission of the required application. Nonprofit corporations who have correctly performed a trademark search and promptly file the required application will usually have no problem obtaining state registration of their trademark. Trademark registration may prevent other entities with similar goods or services from subsequently obtaining a Washington State registration for the same mark, because either the



registered trademark will be included in the searchable databases and will discourage other parties from filing for such mark, or the Secretary of State may refuse to register a similar mark for similar goods or services.

### **c. Federal Registration**

Nonprofit corporations may obtain more expansive trademark rights by submitting an application for a federal trademark registration with the U.S. Patent and Trademark office. This U.S. Patent and Trademark Office requires payment of a filing fee upon submission of the required application. It currently takes at least a year for the application to be reviewed. A copy of a form application provided by the U.S. Patent and Trademark Office for federal registration is available from the Patent and Trademark Office. While federal trademark registration is always recommended, the costs for such registration are more substantial than state registration. Therefore, whether a nonprofit corporation should in fact undertake federal registration requires a cost/benefit analysis that depends on the corporation's resources and goals. A knowledgeable attorney can help the nonprofit corporation with this decision.

## **6. Registering an Internet Domain Name**

If a nonprofit corporation contemplates developing a website at some point, it should consider reserving an appropriate Internet address. A nonprofit corporation may reserve an Internet address at <http://internic.net>. Even if the corporation's trade name and trademark are too long for a convenient address and even if the corporation has no plans for creating a website immediately, prompt reservation of what the corporation thinks would be its most likely address will prevent others from registering that particular address.

## **7. Subsequent Infringement**

Trademark registration serves at least two purposes. First, from a "defensive" perspective, trademark registration helps ensure that no other entity may force a subsequent change in the nonprofit corporation's trade name or trademark. Second, from an "offensive" perspective, trademark registration may increase the ability of a nonprofit corporation to enforce its rights against infringers of its trademark.

Unfortunately, there usually is no government agency or private party charged with enforcing a nonprofit corporation's trade name or trademark rights. Thus, a nonprofit corporation will bear the costs of such action. Such enforcement may require the corporation to hire an attorney and may be relatively expensive and thus not a viable option. For many nonprofit corporations with limited resources, it will be important to remember that, while conducting searches and registering trade names and trademarks will increase the likelihood that they can continue to use their trademarks, they are not purchasing a guarantee that another party will not use a similar trademark such that the other party can be easily forced to stop such use.

## 8. Other Intellectual Property Rights

There are various other intellectual property rights, including patents, copyrights and trade secrets, that may affect a nonprofit corporation's organization and affairs. A description of such rights is beyond the scope of this chapter. However, more information on intellectual property rights can be obtained from the following Internet sites:

General:

1. American Intellectual Property Law Association <http://www.aipla.org>: The home page of the AIPLA provides links to "A Guide to Patent Harmonization," European Patent Costs, Alternate Dispute Resolution, as well as various laws and treaties.
2. Cornell Law School <http://www.law.cornell.edu/topics/topic2.html>: A useful site linking to copyright, patent, trademark, unfair competition and right of publicity/right of privacy sites.
3. Franklin Pierce Law Center IP Mall <http://www.fplc.edu/ipmall>: This site provides links to a variety of intellectual property sites including patent, copyright, trademark, trade secrets, computer law, multimedia law, international resources and technology transfer.
4. Law Journal Extra's Intellectual Property Center <http://www.ljx.com/practice/intellectualproperty/index.html>: From the publishers of the National Law Journal, this site links to news articles in the areas of Intellectual Property and Internet law.
5. National Patent Offices on the <http://www.piperpat.co.nz/patoff.html>: Links to international patent and trademark offices are included in this site.
6. The World Intellectual Property Organization (WIPO) <http://www.wipo.int/eng/index.htm>: This site provides background information regarding the World Intellectual Property Organization, as well as full text of the Patent Cooperation Treaty.

### Trademarks

1. Trademark Act <http://www.law.cornell.edu/uscode/15/ch22.html> Caveat: When viewing the U.S. Code at this site, make sure you follow their instructions on how to determine if a code section has been amended.
2. Global Top-Level Domain Dispute Resolution Policies <http://www.digidem.com/legal/domain.html>: A compilation of the domain name trademark policies of various countries.
3. Saegis from Thomson & Thomson <http://www.saegis.com>: This site requires registration for free use of their domain name database. Access to the trademark database is by subscription.

## Patents

1. European Patent Office <http://www.european-patent-office.org/>: This site provides general information regarding the EPO as well as information on its patent granting procedure.
2. U.S. Patent Act <http://www.law.cornell.edu/uscode/35>: Caveat: When viewing the U.S. Code at this site, make sure you follow their instructions on how to determine if a code section has been amended.
3. U.S. Patent & Trademark Office <http://www.uspto.gov/>: In addition to basic information regarding patents and trademarks, this site includes statutes and international treaties.

## Copyright

1. Berne Convention <http://www.law.cornell.edu/treaties/berne/overview.html>: This site contains the Berne Convention for the Protection of Literary and Artistic Works, Paris Text 1971. The full text can be searched by keywords.
2. Copyright Act of 1976 <http://www.law.cornell.edu/uscode/17> Caveat: When viewing the U.S. Code at this site, make sure you follow their instructions on how to determine if a code section has been amended.
3. Copyright and Fair Use <http://fairuse.stanford.edu/>: This site includes current primary materials, updates and current legislation.
4. U.S. Copyright Office <http://lcweb.loc.gov/copyright/rb.html>: This site provides publications, application forms, announcements, copyright records and general information.

## Trade Secrets

1. Trade Secrets Home Page <http://www.execpc.com/~mhalign>: This site provides general information and recent developments in trade secret law, as well as intellectual property issues on the Internet.

## **I. Merger or Consolidation of a Nonprofit Corporation**

Authored by: [Jeffery Even](#), Assistant Attorney General *State of Washington*

### **1. Generally**

Washington law permits nonprofit corporations to merge with each other, or to form a new corporation by consolidating with each other. The law also permits nonprofit corporations formed in this state to merge or consolidate with nonprofit corporations formed in Washington.

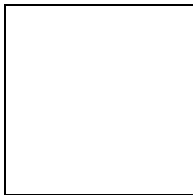
### **2. Merger and Consolidation Distinguished**

Merger and consolidation are similar, but differ in one crucial way. In a merger, two or more corporations join together, with one of those corporations emerging at the end of the process as the surviving corporation. In other words, one of the corporations continues to exist, while the other is merged into it. In a consolidation, by contrast, two or more corporations join together to form a new corporation. Each of the consolidating corporations ceases to exist but instead create a new corporate entity by combining.

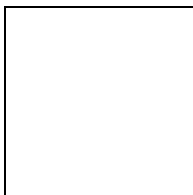
### **3. Issues Effecting a Merger or Consolidation**

#### **a. Plan of Merger or Consolidation**

The process for performing a merger begins with each corporation adopting a plan of merger. That plan must identify:



The names of the corporations planning to merge;



The name of the corporation into which they will merge;

The terms and conditions of the merger;

A statement of any changes in the articles of the surviving corporation to be effected by the merger; and

Such other provisions as are deemed necessary or desirable.

Corporations planning to consolidate must similarly begin by adopting a plan of consolidation containing similar information.

#### **b. Board of Directors or Membership Approval**

The plan of merger or consolidation must then be approved either by the boards of directors of each corporation or by their respective corporate membership. If either of the merging or consolidating corporations have members with voting rights, then the board of directors of that corporation must present the plan to them at either an annual or special meeting. Approval of the plan requires the assent of at least two-thirds of the votes of members present or represented by proxy at a meeting in which a quorum exists. Any merging or consolidating corporations that do not have members with voting rights must approve the plan by vote of a majority of the board of directors then in office at a meeting in which a quorum exists.

#### **c. Articles of Merger or Consolidation**

Upon approval of the articles of merger or consolidation by each of the corporations, an officer of each corporation must file articles of merger or articles of consolidation with the Secretary of State. The articles of merger or consolidation must include the plan of merger or consolidation and a description of the process used by each corporation to approve the plan. If the Secretary of State determines that the articles of merger or consolidation conform to law and that all fees have been paid, the Secretary files the documents and issues a certificate of merger or certificate of consolidation. The merger or consolidation becomes effective upon the filing of the articles of

merger or consolidation or at a later date as provided in the plan of merger or consolidation, which later date must be within thirty (30) days of the filing of the articles of merger or consolidation.

#### **d. Foreign Corporations**

If one or more of the corporations included in the merger or consolidation was not incorporated in Washington, then the merger or consolidation procedure varies somewhat. Washington corporations involved in such a transaction are required to follow the procedures outlined above. Each “foreign” or non-Washington corporation must follow the law of the state in which it was incorporated. If the surviving corporation will be a “foreign” corporation, then the corporation must: (a) obtain a certificate of authority prior to transacting business in Washington, (b) file an agreement that it may be served with process in Washington, and (c) appoint the Secretary of State as its agent to accept service of process.

#### **e. Completion of the Merger or Consolidation**

Once the merger or consolidation has been effected, the several corporations become a single corporation. The separate existence of the corporations that do not survive the transaction cease. The surviving corporation obtains all the rights and duties that the Washington Nonprofit Corporations Act provides and is also responsible for all the liabilities and obligations of each of the corporations involved in the merger or consolidation. In the case of a merger, Washington law deems the articles of incorporation of the surviving corporation to be amended in the manner stated in the plan of merger, and in the case of a consolidation, the articles of incorporation of the new corporation are deemed to consist of the statements contained in the plan of consolidation.

#### **f. Merger and Consolidation Distinguished from an Asset Sale**

As a final note, merger and consolidation should be distinguished from transactions in which a corporation simply disposes of its assets. The process of effecting a merger or consolidation involves changing the actual corporate entities involved. In contrast, if a nonprofit corporation continues to exist but simply sells or otherwise disposes of all or substantially all of its assets, other than through the ordinary course of business, a separate set of statutory rules apply. In such asset disposition transactions, approval is required by either the corporation’s members having voting rights or, if none, by a majority of the corporation’s board of directors then in office.

### **J. Dissolving A Nonprofit Corporation**

#### **1. Generally**

Washington State law provides several methods for dissolving a nonprofit corporation. A corporation can be dissolved: (i) voluntarily, by action of its own directors and members, (ii) administratively by the Washington Secretary of State for failure to comply with filing requirements of that office, or (iii) in very limited circumstances, by a superior court judicial decree.

## **2. Voluntary Dissolution**

### **a. Resolution to Dissolve**

The procedure for voluntarily dissolving a nonprofit corporation begins with a resolution adopted by the board of directors supporting corporate dissolution. If the corporation has members with voting rights, then the resolution must provide that the question of dissolution be submitted to the membership at either an annual or special meeting. Each member with voting rights must be provided with notice of that meeting between ten (10) and fifty (50) days in advance, either personally or by mail. The dissolution then requires a two-thirds vote of the members present or represented by proxy at a meeting in which a quorum is present. If the corporation has no members with voting rights, then a resolution adopted by a majority of the members of the board of directors in office suffices to dissolve the corporation.

### **b. Notice of Adoption of a Resolution to Dissolve**

Once the members or, if no members, the board of directors have adopted the dissolution resolution, then the corporation must cease to conduct its affairs except as necessary to wind up. At that time, the corporation must mail a notice of the proposed dissolution to each known creditor of the corporation, to the Attorney General with regard to certain assets held for a charitable purpose and to the Washington Department of Revenue.

### **c. Plan of Distribution**

In addition to a resolution to dissolve, the corporation must also adopt a plan of distribution providing for the distribution of corporate assets. Like the resolution supporting dissolution, the plan requires the approval of the members having voting rights, but if there are no such members then a majority vote of the board of directors in office suffices to adopt the plan.

State law lists the order of distribution of the nonprofit corporation's assets upon dissolution. First, the corporation must apply its assets toward satisfying all of its liabilities and obligations prior to distributing assets elsewhere. The corporation's liabilities and obligations include all corporate debts, including, presumably, payroll.

Second, if the corporation holds any assets subject to a condition requiring their return or transfer upon dissolution, then any such assets must be returned or transferred in accordance with that condition.

Third, if the corporation holds any assets subject to limitations permitting their use only for charitable purposes, then those assets must be transferred to another corporation, society or organization engaged in activities similar to those of the dissolving corporation. Before transferring any such assets, however, the corporation must notify the Office of the Attorney General, at its Olympia office, of the proposed disposition of such assets at least twenty (20) days before the meeting at which the corporation plans to adopt the plan of distribution. The corporation may not adopt a plan regarding such assets without the approval of the attorney general or of a court of

competent jurisdiction in an action to which the attorney general is a party. However, if the attorney general fails to object within twenty (20) days of the corporation's mailing of the plan of distribution to its office, then state law deems the Office of the Attorney General to have given its approval.

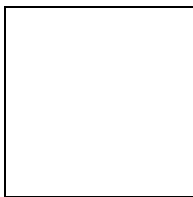
Fourth, the corporation may distribute any of its remaining assets in accordance with its articles of incorporation or bylaws, to the extent that those documents provide for the distribution of assets. If the corporation's articles of incorporation or bylaws do not specify how any other assets should be distributed, then these remaining assets are distributed according to the terms of the plan of distribution.

#### **d. Revocation of Voluntary Dissolution**

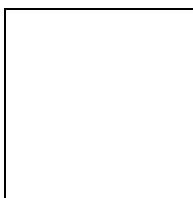
The corporation may revoke its dissolution at any time prior to the issuance of a certificate of dissolution by the Secretary of State. Like the adoption of the resolution to dissolve, revocation of the dissolution resolution requires the approval of corporation's members if there are any having voting rights, or a majority vote of the corporation's board of directors in officers. Any vote by the members requires the support of two-thirds of the members present or represented by proxy at a dully-called meeting in which a quorum is present. Upon the adoption of a resolution revoking the earlier dissolution resolution, the corporation may again conduct its affairs.

#### **e. Articles of Dissolution and Certificate of Dissolution**

After a nonprofit corporation has distributed its assets as described above, it completes the process of dissolution by filing articles of dissolution with the Secretary of State. The articles of dissolution must set forth certain the following statutorily required information:

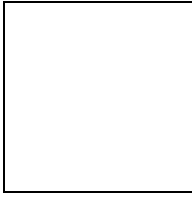


Identification of the corporation by name;

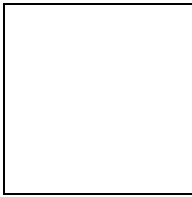


The date of the meeting of the corporation's members adopting the dissolution resolution and a statement that the members adopted the resolution by two-thirds vote or unanimously consented to dissolution in writing. If the corporation has no members, the articles of dissolution must so state, and provide the date of meeting at which the board of directors approved the dissolution;

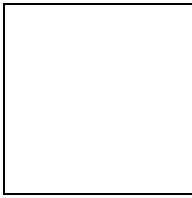




A statement that all of the corporation's debts, obligations and liabilities have been paid or provided for otherwise. In connection with this statement, the corporation must obtain a clearance certificate from the Department of Revenue demonstrating that the corporation does not owe any taxes to the state and must attach a copy of this certificate to the articles of dissolution;



A statement that the corporation's assets have been appropriately distributed; and



A statement that either there are no lawsuits pending against the corporation or that adequate provision has been made for satisfaction of any judgment resulting from a pending suit.

If the Secretary of State finds that the articles of dissolution conform to law, then the Secretary accepts the articles for filing and issues a certificate of dissolution. At that point, the corporation is dissolved.

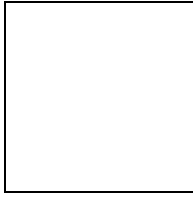
### **3. Involuntary Dissolution**

A nonprofit corporation can also be dissolved involuntarily, either by administrative action of the Secretary of State or judicially.

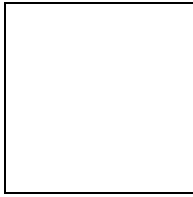
#### **a. Administrative Dissolution**

The privilege of operating as a nonprofit corporation carries with it certain operating requirements. Nonprofit corporations that fail to strictly adhere to these requirements or that cease operation without filing articles of dissolution risk being dissolved by administrative action.

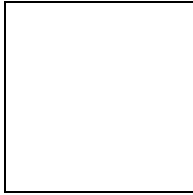
State law requires the Secretary of State to administratively dissolve any corporation that:



Has failed to file or complete its annual report within the time required by law;



Has failed for thirty (30) days to appoint or maintain a registered agent in Washington; or



Has failed for thirty (30) days, after change of its registered agent or registered office, to file in the office of the Secretary of State's Office a statement of such change.

If any of these conditions occur, the Secretary of State mails written notice to the corporation to provide it with an opportunity to correct the problem and avoid dissolution. If the corporation fails to correct the problem, the Secretary of State dissolves the corporation. A corporation that has been administratively dissolved may apply to the Secretary of State for reinstatement as an active corporation by bringing all of its filings up to date, and by paying its back fees and a reinstatement fee.

The possibility of administrative dissolution should provide nonprofit corporations with substantial incentive to comply with the legal requirements of maintaining a corporation. Small and relatively informally operated nonprofit corporations often fail to comply with corporate filing requirements, sometimes with serious consequences. While the Secretary of State must notify a corporation prior to an administrative dissolution and give the corporation an opportunity to cure the problem, the Secretary of State sends this notice by law only to the corporation's registered office.

Consequently, if the corporation has not maintained an accurate, current filing with the Secretary of State as to its registered office, then the corporation may not receive the notice but the administrative dissolution would, nonetheless, be valid.

The consequences of allowing a nonprofit corporation to be dissolved administratively can be a substantial loss of corporate status which may jeopardize the organization's federal tax-exempt status and, not only may the corporation be required to pay a reinstatement fee, but it may find that, during its dissolution period, that another entity took its name. Corporate names must be

distinguishable from those of other entities on file with the Secretary of State. If, during an administrative dissolution period, another corporation reserves or adopts the same or similar name, then the dissolved corporation may be required to change its name as a condition of reinstatement. Additionally, a corporation's opportunity to reinstate as a matter of right is limited to the first three (3) years after the dissolution.

If more than three (3) years have elapsed, then the corporation can only seek reinstatement through a special application process. This late reinstatement option, however, requires a statement under oath by a responsible corporate officer describing the reasons why the corporation failed to make its legally required filings. The Secretary of State can only reinstate the corporation if each of following conditions exist:

☐

There are sufficient exigent or mitigating circumstances;

☐

The corporation has acted in good faith;

☐

The failure to reinstate would cause disproportionate harm to the corporation; and

☐

Reinstatement would not be contrary to the public interest.

#### **4. Judicial Dissolution**

Under rare circumstances, the superior court can dissolve a nonprofit corporation by decree. In an action commenced by the Attorney General, the superior court has the authority to dissolve the corporation if the corporation has either procured its articles of incorporation through fraud or has continued to exceed or abuse the authority conferred upon it by law. There are no reported cases in

Washington's appellate courts of any proceeding under this statute. This may be explained by the fact that the statutory threshold is rather high and that judicial dissolution may be sought only if the statutory conditions are met.

## **5. Judicial Liquidation**

A statute related to judicial dissolution statute permits courts to liquidate the assets of a nonprofit corporation under certain circumstances. The judicial liquidation statute allows either a member or director of the corporation, or the Attorney General, to bring an action to liquidate the corporate assets of a corporation where one of the following conditions exist: (a) management deadlock, (b) illegal, oppressive, or fraudulent actions by those in control of the corporation, (c) misapplication or waste of the corporate assets, or (d) an inability by the corporation to carry out its purposes. As with judicial dissolution, however, this procedure exists as a safeguard against unusual situations, and not as a general method of oversight of corporate internal affairs. Corporate creditors are protected by a similar judicial liquidation procedure which permits creditors to collect outstanding judgments or debts that the corporation admits in writing.

## **6. Effect of Dissolution**

### **a. Generally**

Once a nonprofit corporation has been dissolved, its claim to exist as an entity distinct from its members, officers or directors continues only to the extent provided by state law.

### **b. Voluntary Dissolution**

In the case of a voluntarily dissolved corporation, state law provides that upon adoption of a resolution of dissolution by the members or board of directors, as applicable, the corporation must cease to conduct its affairs, except in so far as may be necessary to "wind-up" the corporation's affairs.

### **c. Administrative Dissolution**

The administrative dissolution of a corporation by the Secretary State causes the existence of the corporation to immediately cease, subject only the corporation's right of reinstatement. The board of directors of the administratively dissolved corporation, however, continues to hold title to the corporation's property as trustees for the benefit of the corporation's creditors and members, if any. This provision precludes there being a gap in ownership of the corporation's assets given the likelihood that, because a corporation's dissolution was involuntary, no distribution plan for the corporation's assets existed.

**d. Third Party Claims**

State law preserves any rights or remedies that a third party may have against a corporation, if properly pursued by any such party within two (2) years after dissolution. In other words, when a corporation dissolves, any party to whom the corporation owes money or is liable due to some event that occurred prior to dissolution may still sue the corporation in the corporate name within two (2) years following dissolution. The corporation or its members, board of directors and officers retain the authority to defend such actions.

**e. Individual Liability After Dissolution**

Corporate dissolution may also create an issue as to whether individuals who incur liability while acting on behalf of a dissolved corporation are entitled to the protection of the corporate form. One of the principal benefits of incorporation is the limitation on individual liability that follows from it. Individuals who continue to act on behalf of the dissolved corporation, with or without knowledge of the dissolution, may be personally liable for their actions. While Washington courts have not addressed this issue in the context of a nonprofit corporation, the Washington Supreme Court has addressed this issue regarding a for-profit corporation. In that case, the Washington Supreme Court concluded that the individual acting on behalf of the dissolved corporation was not personally liable for his actions. Nevertheless, the possibility of personal liability should present individuals with a powerful incentive to avoid administrative dissolution.

## CHAPTER IV MAINTAINING FEDERAL TAX-EXEMPT STATUS FOR YOUR NONPROFIT CORPORATION

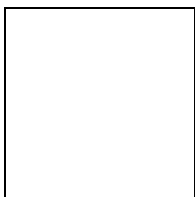
Authored by: [LaVerne Woods](#), *Davis Wright Tremaine LLP* and  
[Tracey Hawk](#), *Davis Wright Tremaine LLP*

### A. Generally

When an organization receives a determination from the Internal Revenue Service that it is qualified under Section 501(c)(3) of the Internal Revenue Code, this is the beginning, not the end, of a compliance process that will continue throughout the organization's life. An organization must continue at all times to comply with tax law requirements in order to maintain its tax exemption.

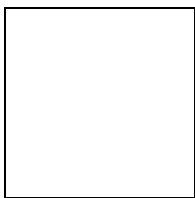
#### 1. Specifically:

The organization must be organized and operated at all times exclusively to further charitable purposes;

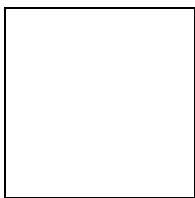


“insider;”

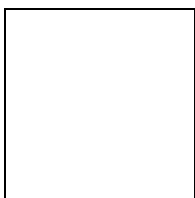
It must not allow any of its assets to “inure” to the benefit of an



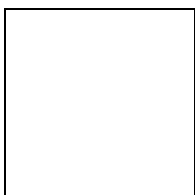
It must not participate in any campaign for political office;



It must not engage in attempts to influence legislation as any substantial part of its activities;



It must report and pay tax on any unrelated business income; and



It must comply with a variety of annual reporting and public disclosure requirements.

Each of these issues is addressed in more detail below. In general, the discussion addresses Section 501(c)(3) organizations that are qualified as public charities (non-private foundations) under federal law. A more restrictive set of rules applies to Section 501(c)(3) organizations that are private foundations. The private foundation rules are beyond the scope of this text, but are introduced and discussed briefly in [Chapter II, Section A](#).

## **B. Charitable Activity**

### **1. Charitable Purposes**

Federal tax law provides that for an organization to qualify for the tax exemption under Section 501(c)(3), it must be organized and operated exclusively for charitable, religious, scientific, educational, and certain other purposes. In order to maintain its tax-exempt status, a Section 501(c)(3) organization must comply with this standard throughout its entire period of existence. If its purposes change – either in terms of how its purposes are stated in its Articles of Incorporation and Bylaws, or in terms of the organization’s activities – its qualification for exemption may also change.

The tax law recognizes a wide variety of purposes and activities as being “charitable.” While Section 501(c)(3) enumerates other qualified purposes, such as religious and educational purposes, the law interprets these as subsets of the general category of charitable purposes, and not as separate categories. Charitable purposes include relief of the poor, the advancement of religion, the advancement of education or science, the erection or maintenance of public buildings or monuments, lessening the burdens of government (in limited circumstances), promoting social welfare, lessening neighborhood tensions, eliminating prejudice and discrimination, defending human and civil rights secured by law, combating community deterioration and juvenile delinquency, and protecting the natural environment. Educational purposes, as a subset of charitable purposes, include both instruction of the public and the individual. Educational activities include educational publications as well as visual and performing arts.

In order for an organization's activities to qualify as charitable, they must benefit the general public, or a segment of the general public broad enough to be considered a charitable class. For example, an educational organization formed to educate the children of one family will not qualify as charitable. In addition, activities that violate public policy, such as the provision of education on a racially discriminatory basis, will not qualify as charitable.

“Exclusively” for Charitable Purposes Means “Substantially.” While the tax law specifies that a Section 501(c)(3) organization must be organized and operated “exclusively” for charitable purposes, the Treasury Regulations provide that an exempt organization may also engage in activities that do not specifically further a charitable purpose, provided that such activities do not constitute more than an “insubstantial” part of the organization's total activities. Accordingly, a Section 501(c)(3) organization may engage in a limited amount of activities that are not strictly charitable, so long as the activities do not violate any of the rules described below.

Activity Itself Must be Charitable, Not Just the End Use for Funds. Each organization's activities must be evaluated separately to determine whether it furthers a charitable purpose. The fact that funds generated from an activity may ultimately be used to further a charitable purpose will not by itself cause the activity to be charitable. For example, the operation of a sandwich shop for paying customers is not charitable even though all net income from the shop may be used for charitable purposes. The operation of a soup kitchen for the homeless, on the other hand, is charitable.

## **C. Private Inurement**

### **1. General Prohibition**

A Section 501(c)(3) organization must be operated in such a manner that none of the organization's assets “inures to the benefit” of any private individual. Private inurement occurs when a person who is an “insider” with respect to the organization, such as an officer or director, derives a benefit from the organization without giving something of at least equal value in return.

The determination of whether a person is an insider is based on all relevant facts and circumstances and will generally depend on the level of influence that the individual has over the organization. Entities such as corporations and partnerships that are controlled by insiders may also be treated as insiders with respect to an exempt organization. For example, a corporation that is wholly owned by an organization's board member will likely be an insider with respect to the organization.

In order to identify and avoid potential private inurement situations, an organization should adopt a conflict of interest policy and should annually survey its board members, officers and senior staff to identify all organizations in which they or their family members have substantial interests, and to identify all situations in which the organization has financial dealings with potential insiders. The organization must take care to insure that all such arrangements are at arm's length.



The IRS may revoke an organization's tax-exempt status if any private inurement occurs. As a technical matter, there is no de minimis exception. Private inurement may arise in many ways. Some of the most common situations are described below.

## **2. Compensation Arrangements**

A Section 501(c)(3) organization may pay reasonable compensation to employees or others for services rendered. Excessive compensation, however, such as compensation that exceeds payments commonly made by similar organizations for similar services, may result in inurement. When practical, it is advisable to have an independent consulting firm advise on salaries and benefits for senior executives.

As a general rule, a Section 501(c)(3) organization should not pay any person a salary or other compensation that is calculated as a percentage of the organization's net earnings. For example, an organization must not pay its executive director a salary calculated as 10% of the organization's net income. This would be private inurement and could result in revocation of the organization's exemption.

## **3. Purchases and Sales**

If a Section 501(c)(3) organization purchases property or services from an insider for more than adequate consideration or pays rent in excess of fair market value, this may constitute private inurement. Similarly, if an organization furnishes property or services to an insider without receiving adequate compensation, inurement may result. If the organization provides property or services for less than fair market value to the general public in the course of fulfilling its tax-exempt purposes (e.g., an orchestra performing free concerts), private inurement generally will not result.

## **4. Loans**

If a Section 501(c)(3) organization borrows money from an insider at a rate of interest that is above a market rate, or loans money to an insider without receiving adequate security or reasonable interest, this may also create inurement.

## **5. Joint Venture Arrangements**

Inurement may also arise from joint venture arrangements between Section 501(c)(3) organizations and for-profit entities, especially in situations where, under the joint venture arrangement, the for-profit entity enjoys unfettered control over the exempt organization's assets or operations or receives a percentage of its net earnings.

## **D. Intermediate Sanctions**

### **1. Overview**

The penalty for private inurement, as discussed above, is revocation of the organization's tax exemption. The tax law also imposes penalties on certain persons who engage in impermissible transactions with charitable organizations. The IRS may impose such penalties as an intermediate step instead of revoking the organization's exempt status, or it may penalize individuals in addition to revoking exemption.

### **2. Outline of Penalties**

The tax law imposes a penalty tax on any "disqualified person" (defined below) who engages in an "excess benefit transaction" (defined below) with certain organizations that are exempt from tax under Sections 501(c)(3) and 501(c)(4), and on "organization managers" who knowingly and willfully approve such transactions.

Initially, the tax on a disqualified person is 25% of the excess benefit that the disqualified person received. For example, if the person sold property to the organization for \$10,000, when the fair market value was really \$4,000, the excess benefit is \$6,000 and the initial tax is \$1,500 (25% of \$6,000). If the transaction is not "corrected" (i.e., undone to the extent possible), the disqualified person is subject to an additional tax of 200% of the excess benefit. In our example, the additional tax is \$12,000.

In addition, an "organization manager," such as a board member, officer or executive director, may be subject to a separate tax if the manager approves an excess benefit transaction knowing that it is an improper transaction, unless the action is not willful and is due to reasonable cause. The tax is 10% of the excess benefit, up to a maximum of \$10,000 for each excess benefit transaction. In our example, the tax on an organization manager would be \$600.

The intermediate sanctions rules do not penalize the exempt organization itself.

### **3. "Disqualified Person"**

A "disqualified person" is any person who is in a position to exercise substantial influence over an organization with respect to a transaction. Once a person is classified as a disqualified person, he/she will continue to be a disqualified person for a period of five years after he/she ceases to exercise such influence. A member of any disqualified person's family is also a disqualified person, as is a corporation, partnership, trust, or estate in which a disqualified person directly or indirectly owns more than a 35% interest.

Under Proposed Treasury Regulations, a voting member of a Section 501(c)(3) organization's governing body is automatically a disqualified person, as are the organization's president, chief executive officer, chief operating officer, treasurer and chief financial officer. An individual's

authority and responsibilities, rather than the person's title, determines whether he or she holds one of these positions. An individual who has or shares ultimate responsibility for implementing the governing body's decisions or supervising the organization's management, administration or operations will be a disqualified person, as will anybody who has or shares ultimate responsibility for managing an organization's financial assets, including check-signing authority, and authority to authorize electronic fund transfers.

Proposed Treasury Regulations provide that an employee who receives economic benefits from an exempt organization of less than \$80,000 per year is not a disqualified person, so long as the individual is not otherwise a disqualified person under one of the categories above. For example, an executive director who receives \$30,000 per year will be a disqualified person by virtue of his or her role as chief executive officer, regardless of the fact that his/her salary is less than \$80,000.

In cases not covered by the rules above, the question of whether a person is a disqualified person is determined on the basis of all relevant facts and circumstances bearing on the person's level of influence over the organization with respect to a transaction.

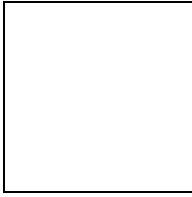
#### **4. "Excess Benefit"**

An "excess benefit transaction" is any transaction in which a Section 501(c)(3) or Section 501(c)(4) organization provides an economic benefit, either directly or indirectly, to a disqualified person, where the value of that economic benefit exceeds any value that the organization receives in return, including the value of services performed. For example, the payment of a salary of \$50,000 for services, where the fair market value of the services is \$25,000, is an excess benefit transaction.

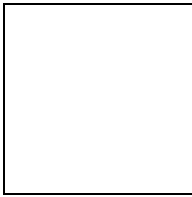
Proposed Treasury Regulations provide that the payment of reasonable expenses for board members to attend meetings, as long as these do not include luxury travel or payments for spouses, do not constitute excess benefit transactions. Similarly, benefits that are provided to members of the public in exchange for an annual membership fee of \$75 or less, such as discounted admission to events or receipt of a newsletter, do not constitute excess benefits.

#### **5. Rebuttable Presumption of Reasonableness**

Under Proposed Treasury Regulations, an organization can establish a rebuttable presumption that a transaction is reasonable (and therefore not an excess benefit transaction) when the three requirements set out below are satisfied. In general, organizations should seek to qualify for the rebuttable presumption in approving any transaction with a potential disqualified person. If an organization is unable to establish the rebuttable presumption for a transaction, however, there is no inference that it is an excess benefit transaction. The three requirements are:

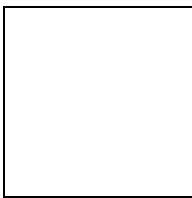


Approval by Independent Board or Committee. The transaction must be approved by a board or committee composed entirely of individuals who are not themselves disqualified persons with regard to the transaction and are not related to or controlled by a disqualified person.



Appropriate Comparability Data. The board or committee must rely on appropriate comparability data. The issue of what data is appropriate is critical. Where the transaction involves the purchase or sale of property, an independent appraisal is appropriate data.

Where the transaction involves the payment of executive compensation, the board or committee should obtain a carefully tailored compensation survey that considers a variety of factors, such as geographic location, the size of the organization, relevant experience and comparability of services. A special rule applies for organizations with annual gross receipts of less than \$1 million. In this case, comparability data for compensation is appropriate if it consists of compensation paid by five comparable organizations in the same or similar communities for similar services. An informal survey of similar organizations can accordingly be essential in establishing the rebuttable presumption.



Concurrent Written Documentation. The board or committee must concurrently document the basis for its decision in writing, e.g., through minutes. The written documentation must include the terms of the transaction; the date it was approved; the members of the board or committee who were present during debate and those who voted on it; the comparability data obtained and how it was relied on; and the action taken by anyone who is a member of the board or committee but who had a conflict of interest.

In order for the decision to be documented concurrently, the records must be prepared by the next board or committee meeting and must be approved within a reasonable period.

## **6. Final Regulations**

The issuance of final intermediate sanction regulations is on the IRS work plan for the year 2000. In the meantime, the IRS has begun imposing intermediate sanctions.

### **E. Political Activity**

Federal tax law prohibits any Section 501(c)(3) organization from participating in any political campaign on behalf of or in opposition to any candidate for public office. This prohibition is absolute and any violation may result in loss of an organization's exempt status. The prohibited activity includes publishing or distributing written statements or making oral statements on behalf of or in opposition to a candidate, and paying salaries or expenses of campaign workers.

Section 501(c)(3) organizations must take care to avoid any inadvertent violation of the prohibition against political activity. For example, an organization should not invite a candidate to speak at an organization-sponsored function during an election cycle, because this may be treated as an implicit endorsement. Organizations should also refrain from publishing voter education materials that may create an appearance of bias regarding issues that are significant to the organization, e.g., a "voter's guide" that compiles incumbents' voting records only on issues that are important to the organization.

### **F. Legislative Activity ("Lobbying")**

#### **1. "No Substantial Part" Limitation**

The tax law distinguishes "political activity," (i.e., participating in campaigns for political office) from attempts to influence legislation. An organization engages in attempts to influence legislation (commonly referred to as "lobbying") if it contacts legislators or their staffs – or urges the public to do so – for the purpose of proposing, supporting or opposing legislation.

A Section 501(c)(3) organization that is a public charity may engage in lobbying, but only if such activities do not constitute a "substantial" portion of the organization's activities. If the IRS determines that a public charity has engaged in substantial attempts to influence legislation, the organization's exemption may be revoked. It is unclear when lobbying activity will be deemed to constitute a "substantial" portion of an organization's activities; there is no precise standard.

Certain other types of tax-exempt organizations, e.g., social welfare organizations qualifying under Section 501(c)(4), are not subject to limitations on legislative activities. If an organization wishes to engage primarily in lobbying, it should seek exemption under a category other than Section 501(c)(3).

## **2. Section 501(h) Election**

### **a. Generally**

Section 501(c)(3) organizations that are public charities, other than churches, may make an election under Section 501(h) of the Internal Revenue Code to become subject to a more objective standard for lobbying activities than the “substantiality” test. Section 501(h) provides specific dollar limits on lobbying expenditures. An organization making the election may spend up to 20% of the first \$500,000 of its annual operating budget on lobbying. (Only 25% of that amount may be spent in “grassroots” lobbying, however, as defined below.) As an organization’s annual budget increases over \$500,000, the percentage that may be spent on lobbying decreases. There is an absolute annual maximum on lobbying expenditures of \$1 million, which is reached at an annual budget of \$17 million.

If an organization exceeds its limit in any year, it will be subject to an excise tax of 25% on the excess amount. Only if the organization exceeds its permitted expenditures by 150% over a four-year period will it lose its tax-exempt status.

The election is made by filing IRS Form 5768 which can be obtained at the locations. (IRS publication providing information on exempt organizations).

### **b. Advantages of Election**

The principal advantage of the Section 501(h) election is that it avoids the ambiguity of the vague “substantiality” test. The election also allows an organization to take advantage of specific exceptions to what constitutes lobbying under the tax law. In general, the Section 501(h) election allows an organization to plan lobbying expenditures with much greater certainty regarding the tax result. In addition, the excise tax that applies to excessive lobbying expenditures of an electing organization is much less harsh than the loss of tax-exempt status that can apply to a non-electing organization. An organization that anticipates any regular attempts to influence legislation is generally well advised to make the Section 501(h) election.

## **3. “Attempts to Influence Legislation” Under Section 501(h).**

### **a. “Legislation”**

“Legislation” includes action by the Congress, state legislature, local council, or similar legislative body, or by the public in a referendum, ballot initiative, constitutional amendment or similar procedure. It includes both legislation that has already been introduced in a legislative body and a specific legislative proposal that the organization either supports or opposes. It does not, however, include executive action, judicial processes, or the work of administrative agencies such as school boards, housing authorities, sewer and water districts and zoning boards, whether elective or appointive. Attempts to influence the actions of regulatory agencies accordingly are not lobbying, even where the agency is primarily concerned with promulgating regulations to effectuate legislative mandates.

### **b. Direct Lobbying Communication**

Attempts to influence legislation include “direct” lobbying, defined as communications with any member or employee of a legislative body or any governmental official or employee who may participate in formulating legislation, if the principal purpose of the communication is to influence legislation. A communication with a legislator or governmental official will be treated as a direct lobbying communication if it: (1) refers to specific legislation; and (2) reflects a view regarding the legislation.

### **c. Grass Roots Lobbying Communication**

**Generally.** Attempts to influence legislation also include “grass roots” lobbying communications. These are communications that attempt to affect the opinion of the general public or a segment of the public, and that: (1) refer to specific legislation; (2) reflect a view regarding the legislation; and (3) encourage the recipient to “take action.”

**“Taking Action.”** A communication encourages the recipient to take action if it: (1) encourages the recipient to contact a legislator; (2) gives the address, telephone number or other contact information for the legislator; (3) provides a petition or tear-off postcard for the recipient to communicate with the legislator; or (4) specifically identifies one or more legislators who will vote on the legislation. Mass media advertisements within two weeks before a vote on a highly publicized piece of legislation will be presumed to constitute grass roots lobbying if the advertisement reflects a view and encourages communication with legislators, even if it does not encourage the recipient to take action.

## **4. Exceptions to Definition of “Attempts to Influence Legislation”**

### **a. Nonpartisan Analysis, Study or Research.**

A Section 501(c)(3) organization may provide the public or legislators the results of any of its “nonpartisan analysis, study or research.” This includes any independent and objective exposition of a particular subject matter, including educational materials. The materials may advocate a particular position, so long as they present sufficient facts to allow the audience to form independent conclusions. If the communication directly encourages the recipient to take action with respect to specific legislation, then it is excluded from this exception.

### **b. Technical Advice or Assistance**

An organization that has developed a particular expertise in a given area may be called upon to render technical advice or assistance to a legislative committee or subcommittee. Provided that the invitation to do so is issued in writing by the committee or subcommittee, rather than an individual member, the organization’s response to that request will not constitute lobbying activity.

**c. “Self Defense”**

An electing organization may appear before, or communicate with any legislative body with respect to a possible decision of that body which might affect the organization’s existence, its powers and duties, its tax-exempt status, or the deductibility of its contributions.

**d. Examinations and Discussions of Broad Social, Economic and Similar Problems**

The participation in, or sponsorship of, public discussion on issues of general concern will not constitute lobbying, provided that such discussion does not address the merits of a specific legislative proposal, and does not directly encourage participants to take action with respect to legislation.

**G. Unrelated Business Income (“UBI”)**

**1. Tax Liability**

While a Section 501(c)(3) organization is not generally subject to federal income taxation on its income, it will be taxed on any income derived from an “unrelated trade or business.” Such income is referred to as unrelated business income, or “UBI.” UBI is taxed at graduated rates that apply to taxable corporations.

The purpose of the unrelated business income tax is to treat exempt organizations in the same manner as their taxable counterparts when they are regularly engaging in income-producing activities that do not further a charitable purpose. An organization’s tax exemption may be jeopardized if a substantial part of its activities constitutes unrelated business activities.

**2. “Unrelated Trade or Business”**

An exempt organization’s activity will constitute an unrelated trade or business if all of the following three factors are present:

**a. Trade or Business**

The activity is a trade or business, defined as any activity carried on for the production of income from selling goods or performing services;

**b. Regularly Carried On**

The trade or business is frequent, continuous and pursued in a manner similar to comparable activities of non-exempt organizations; and



**c. Not Substantially Related**

The trade or business is not substantially related to the organization's exempt purpose. An activity is substantially related if the conduct of the activity has a substantial causal relationship to the achievement of exempt purposes (other than the production of income). In short, the activity must contribute importantly to the organization's exempt purposes. It is not enough that the net income from the activity will be used to further charitable purposes. The conduct of the activity must itself be charitable. For example, the operation of a restaurant where all net income will be used for charitable purposes is not charitable. On the other hand, the operation of a restaurant used exclusively as a job-training program for indigent persons may be charitable.

**3. Exceptions for Certain Activities**

Certain activities are excluded from the definition of an unrelated trade or business, and income from these activities accordingly is not UBI.

**a. Volunteer Exception**

A business in which substantially all of the work is carried on by uncompensated volunteers does not generate UBI. For example, operation of a retail store where all of the work is performed by unpaid volunteers is not an unrelated trade or business, and any income generated is not UBI.

**b. Convenience Exception**

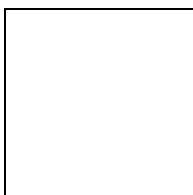
A business carried on primarily for the convenience of an exempt organization's members, students, patients, officers or employees is not an unrelated trade or business, and does not generate UBI. For example, a hospital cafeteria for employees, patients and visitors does not generate UBI.

**c. Donated Merchandise**

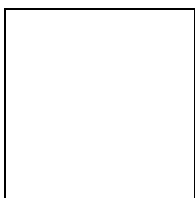
A business of selling merchandise, substantially all of which has been donated to the organization, is not an unrelated trade or business, and does not generate UBI. For example, a retail thrift store in which all merchandise sold is donated to the organization does not generate UBI.

**d. Exclusions for Investment Income**

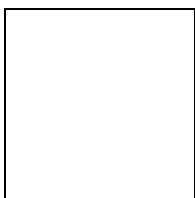
The following are excluded from UBI, and therefore generally are not taxable, on the grounds that they are passive income from investment assets:



Dividends, royalties, interest and annuities are all excluded from UBI.



Rents from real property and personal property are excluded, but income from debt-financed real property, discussed below, may be UBI.



Gains from the sale or exchange of property are generally excluded. For example, a Section 501(c)(3) organization is not subject to tax on gain on its sale of stock. If the organization regularly sells items that constitute inventory, however, and the sales activity does not further charitable purposes, e.g., sales of commercial magazines, then the income may be taxable.

#### **e. Deductions**

Each Section 501(c)(3) organization is permitted a “standard deduction” in the amount of \$1000 against any UBI earned in a taxable year, which amounts to an effective exemption from tax on the first \$1000 of UBI. Organizations may also deduct expenses attributable to unrelated business activities in calculating net UBI.

#### **f. “Debt-Financed Income”**

While rents from real property are generally excluded from UBI, income from “debt-financed property” is not. The rules regarding debt-financed property are complex and confusing, and a full discussion is beyond the scope of this text.

Essentially, the policy behind the rules is as follows. It may be appropriate generally not to tax an organization on traditional investment income such as interest, dividends and rents, because this is the type of income that a charity typically earns from investment of its endowment. Such items should be taxed to the extent that the organization borrowed to acquire the income-producing property, where the use of the property is not in and of itself charitable.

For example, assume that an organization acquires a building, subject to a mortgage for 80% of the purchase price, and uses half of the building for its administrative offices and its charitable purposes, while it leases the other half of the building to other organizations. The rental activity itself is not charitable. Under the debt-financed income rules, 80% (the extent of debt-financing) of the rental income will accordingly be taxed as UBI.

## **12. Excessive UBI May Jeopardize Exemption**

An exempt organization's tax-exempt status may be jeopardized if more than an "insubstantial part" of its activities constitutes unrelated business activities. While there is no precise quantitative test for "substantiality," the IRS has ruled that there is no quantitative limit so long as an organization carries on a charitable program "commensurate in scope with its financial resources." The IRS has also ruled that unrelated business income constituting 5% of an organization's gross income does not jeopardize its tax exemption.

If an exempt organization's status is threatened by the extent of its unrelated business activities, it should consider spinning off the unrelated activity into a for-profit subsidiary. Assuming that proper corporate formalities are met, the subsidiary's activities should not affect the parent's exempt status. The subsidiary will be taxed on net income from its activities.

## **H. Federal Filing Requirements**

### **1. Annual IRS Form 990**

#### **a. Filing Requirement**

Most tax-exempt organizations must file an annual information return with the IRS. For Section 501(c)(3) organizations that are public charities, and most other types of tax-exempt organizations, the return is made on IRS Form 990 or Form 990-EZ.

#### **b. Exceptions**

Tax-exempt organizations (other than private foundations) that do not normally receive more than \$25,000 in gross receipts each year are not required to file an information return. Churches and certain religious organizations that are affiliated with a church are not required to file.

#### **c. Filing Date**

The return must be filed on or before the 15<sup>th</sup> day of the fifth month following the close of an organization's annual tax accounting period (i.e., May 15, for a calendar-year organization).

#### **d. Professional Preparation**

An organization may, at its election, either prepare its own Form 990 returns or utilize a professional service. Section 501(c)(3) organizations that rely on a public support test for public charity classification should seriously consider engaging a professional with experience in preparing this type of return.

**e. Treatment as a Public Relations Document**

Form 990 returns are public documents. A Section 501(c)(3) organization must disclose to the public its Form 990 returns for the three most recent tax years. Accordingly, a tax-exempt organization should consider its Form 990 returns to be public relations tools and should treat the preparation process as an opportunity to advertise the organization's programs and good works to the public.

**f. Penalties**

Failure to file a Form 990 in a timely manner may result in penalties of \$20 per day, with a cap of the lesser of \$10,000 or 5% of the organization's gross receipts for the year. For large organizations (gross receipts exceeding \$1 million for any year), the penalty is \$100 per day, with a cap of \$50,000. The penalty may be abated if reasonable cause can be shown.

**g. Organizations With a Tax Exemption Application Pending**

Organizations that have applied for tax exemption but have not yet received a determination letter should file a Form 990 or other applicable form as if their tax-exempt status had been granted.

**2. Form 990-T: Organizations With UBI**

An exempt organization that has more than \$1000 of UBI in a taxable year must report such income on Form 990-T, which must be filed in addition to the informational Form 990. Exempt organizations are also required to make quarterly estimated UBI tax payments, calculated at corporate rates. Penalties apply for late filing, late payment or underpayments of taxes on income reportable on Form 990-T. Organizations generating UBI are well advised to seek the assistance of an accountant.

**3. Federal Returns and Reports Required of Organizations with Employees**

Federal Income Tax Withholding. Most tax-exempt organizations are required to withhold and pay federal income tax with respect to wages of their employees in the same manner as for-profit organizations. Organizations should consult a bookkeeper, accountant or payroll management advisor regarding this and the other requirements listed in this section. (See [Chapter V, Section D.](#))

**4. Social Security Taxes**

Most tax-exempt organizations are required to withhold and pay Federal Insurance Contributions Act (FICA) taxes in the same manner as for-profit organizations. (See Chapter V, Section D.)

## **5. Federal Unemployment Taxes**

A Section 501(c)(3) organization is not required to pay federal unemployment taxes, but may elect to participate in a state program. (See [Chapter V, Section D.](#))

## **6. Information Returns for Payees**

Tax-exempt organizations are required to prepare and file annually certain forms for purposes of reporting amounts paid to employees and others, in the same manner as for-profit organizations. These include Forms W-2 and 1099.

## **7. Reporting Material Changes in the Organization to the IRS**

**Changes to Legal Structure** Any organization that makes material changes to its legal structure may be required to file a new exemption application to ensure continued qualification for exemption. (See [Chapter II.](#))

**Amendments to Articles or Bylaws.** If an organization amends its Articles of Incorporation or Bylaws, it should notify the IRS by submitting a conformed copy of the changes along with its annual Form 990. Organizations that are not required to file a Form 990 should notify the IRS district director of any such change. The address for notification should appear on the organization's IRS determination letter.

# **I. Public Disclosure of Exemption Application and Form 990 Returns**

## **1. Information Disclosure.**

A Section 501 (c)(3) organization must furnish a copy of its Form 1023 exemption application to any person who requests a copy. A limited exemption applies to an organization that filed its application before July 15, 1987, but only if the organization did not have a copy of the application on that date. A Section 501(c)(3) organization that is a public charity must also furnish copies of its annual IRS Form 990 for its three most recent tax years upon request. A public charity is not required to disclose the portion of the return that identifies the names and addresses of contributors to the organization, nor is it required to disclose Form 990-T (unrelated business income return). Similar rules apply to private foundations, except that the contribution list is subject to disclosure.

If the request is made in person the organization must provide a copy on the day the request is made. In unusual circumstances where this would be unreasonably burdensome, the organization may provide the copy on the next business day. The organization must provide a copy in response to a written request within 30 days.

## **2. Fees**

An organization is entitled to charge a reasonable fee for producing copies and for any mailing charges incurred in their delivery. Charges may not exceed \$1 for the first page and \$.15 for each additional page, plus the actual postage costs. An organization may collect payment in advance of providing the requested copies.

## **3. Exceptions**

A Section 501(c)(3) organization can avoid the requirement to provide copies by making the necessary documents “widely available.” An organization can make its documents widely available by posting them on the organization’s World Wide Web page on the Internet, or by having the documents posted on another organization’s web page as part of a database of similar materials. A limited exception to the disclosure rules also applies to organizations that have been subject to a harassment campaign where a waiver of the rules would be in the public interest.

## **4. Penalties for Failure to Disclose**

A penalty of \$5000 applies for any failure to provide copies of the required Form 990 returns or the Form 1023 exemption application.

# **J. Donor Substantiation**

## **1. Requirements for Donor: Written Receipts for Donations of \$250 or More**

In order for a donor to deduct a contribution of \$250 or more, the donor must obtain a written receipt from the recipient charity. The receipt must verify the amount of the contribution and must specifically state whether the charity provided any goods or services, such as a dinner or concert, in consideration for the contribution. If so, the receipt must include a good faith estimate of the value of the goods or services provided. If the donation is of property other than cash, the receipt must describe the property. The charitable organization may provide a separate acknowledgment for each contribution, or provide donors with an annual or more frequent acknowledgment that sets out the required information for each contribution of \$250 or more. A canceled check will not satisfy this substantiation requirement.

## **2. Requirements for Charity: Receipts for “Quid Pro Quo” Contributions**

A charity that receives a payment partly as a contribution and partly as payment for goods or services has received a “quid pro quo” contribution. A charity that receives a quid pro quo contribution in excess of \$75 must provide the donor with a written statement setting out the amount of the payment that is deductible as a contribution. This statement must indicate that the deduction is limited to the excess of the amount of the contribution over the value of the goods or services provided to the donor, and must include a “good faith estimate” of the value of the goods or

services. Failure to make this required disclosure can result in penalties of \$10 per contribution, with a total maximum penalty of \$5,000. An exception to the quid pro quo rules may apply if a charity provides only token goods and services, such as mugs or calendars.

### **3. Sale or Exchange of Donated Property**

An individual or entity contributing property to a Section 501(c)(3) organization and claiming a deduction for more than \$5,000 must obtain an appraisal and report the donation on IRS Form 8283. If the recipient organization disposes of the property within two years after its receipt, the organization must file IRS Form 8282, indicating the property's sale price, and must provide a copy to the donor.

## CHAPTER V Employment Issues

Authored by: [Nalani Askov](#), Attorney at Law and [Seema Nanda](#), Davis Wright Tremaine LLP

### A. Generally

Nonprofit corporations are employers like all other employers, and are subject to the same laws. The array of employment issues that arise for employers are too numerable to mention here, but this chapter highlights some of the salient issues for nonprofits. For specific advice, you should consult an attorney.

### B. Employment Discrimination

Like all other employers, most nonprofits are subject to all federal, state, and local employment discrimination laws. There are some limited exceptions for religious organizations but for the most part they must deal with their employees in a non-discriminatory manner as well. There are also limited exceptions for freedom of association. Consult with an attorney before excluding anyone. Litigation often centers on the following topics:

#### 1. Major Discrimination Laws

##### a. Federal Law

Nonprofits are subject to numerous federal laws, including Title VII of the Civil Rights Act of 1964 and the Americans with Disabilities Act. Both of these Acts cover employers with 15 or more employees.

##### b. State Discrimination Laws

Washington nonprofits are subject to numerous discrimination laws, including the Washington State Law Against Discrimination, which applies to employers with at least eight employees, even if fewer than eight employees are in Washington. It also protects the rights of independent contractors in certain situations. While the statute only applies to organizations with eight or more employees, Washington courts have applied some of the protections of the discrimination law to employers with fewer than eight employees through the common law. All employers, no matter what size, should therefore be cognizant of the law.

The Washington Law Against Discrimination prohibits discrimination on the basis of age, race, sex, disability, marital status, national origin or creed. It prohibits disparate treatment of all sorts—in hiring, firing and terms and conditions of employment. Nonprofits who serve primarily men or women need to pay close attention to whether they are giving preference to men or women on the basis of sex. An employer can only hire on the basis of sex if gender is a bona fide occupational qualification reasonably necessary to the normal operation of the employer's particular business.



The standard is very high, and requires that all or substantially all persons in the excluded class would be unable to efficiently perform the duties and the essence of the operation would be undermined by hiring anyone in that excluded class. Employers should consult an attorney before determining not to hire an individual on the basis of sex.

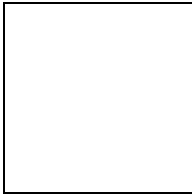
### **c. City of Seattle Ordinance**

Seattle law prohibits discrimination on the basis of a few factors in addition to those in the Washington State Laws Against Discrimination, including sexual orientation and political ideology. In February 1999, the Seattle City Council passed an amendment to this ordinance, permitting private lawsuits, including those based on sexual orientation.

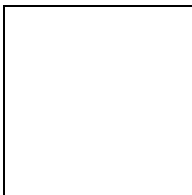
## **2. Keys to Avoiding Common Discrimination Litigation**

### **a. Disability Discrimination**

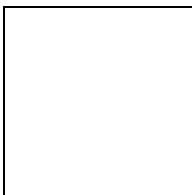
An employer must reasonably accommodate a “qualified” employee’s disability, unless doing so would pose an undue hardship on the employer’s business. The terms disabled, reasonable accommodation, and undue hardship are difficult to define. Employers should have an understanding of these terms or work with an employment attorney when a disability issue arises with an employee. Here are some broad principles:



Never assume an employee is not disabled. Washington law defines discrimination extremely broadly: a disability is an “abnormal condition” which forms the basis for discrimination.

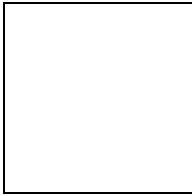


Never assume that an employee is not disabled because her condition does not accord with your definition of a disability.



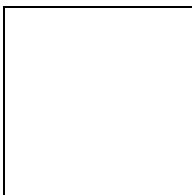
Always engage in an “interactive process” with disabled employees. Washington law requires employers to work with a disabled employee in devising a

reasonable accommodation. This may involve working with the employee's doctors and going back and forth to determine how the employee can successfully complete the essential functions of the job.

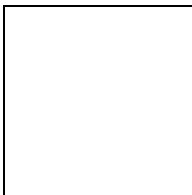


leave.

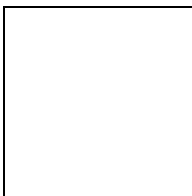
Have clear policies on calling in late for work, absences and sick



Make sure that you have up-to-date job descriptions for each position which clearly outline the essential functions of the job.



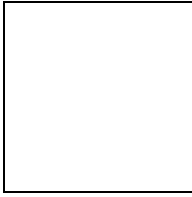
Don't assume that making certain concessions would pose an undue hardship to your agency organization simply because you are a nonprofit.



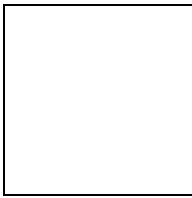
Undue hardship is defined narrowly and is often left for a jury to determine.

#### **b. Harassment**

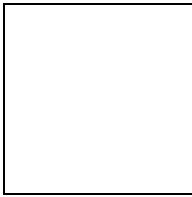
In 1998, the United States Supreme Court determined that there was a presumption that an employer failed to protect an employee from sexual or other harassment unless the following procedures were in place:



A clear anti-harassment policy informing all employees that workplace harassment based on sex, race, or any other protected classification will not be tolerated and will result in disciplinary action. The policy should also contain a clear complaint procedure including an option enabling the complaining employee to bypass the alleged harasser as well as assurances that employees who do make claims of harassment will be protected from retaliation.



Documented distribution of the employer's anti-harassment policy. Many employers require employees to individually sign a statement to confirm receipt;



Training programs to ensure that managers and employees understand what constitutes sexual harassment, and how the employer's sexual harassment complaint procedure operates.

### **c. Investigation of Complaints**

Employers must respond promptly to complaints, treat them seriously, investigate them thoroughly, and then take appropriate action designed to end any harassment that is found to have occurred.

## **C. Dealing with Volunteers, Employees and Independent Contractors**

### **1. Volunteer, Independent Contractor or Employee?**

People who are volunteers, employees or independent contractors do the work of every organization. An organization has different legal responsibilities with respect to each person depending on his or her legal status. Failure to properly characterize employees can present a serious liability risk for the organization including significant monetary penalties.

To meet its legal responsibilities, an organization must determine whether the individuals who perform work for it are employees, independent contractors or volunteers. Persons identified as

employees must then be characterized as either “exempt” or “non-exempt” for purposes of payment of overtime and minimum wages. Unfortunately, determining whether a person is an employee, independent contractor or volunteer can be complex and the tests vary depending on which law is involved. Basic guidelines are provided below, but specific legal advice should be sought before applying these guidelines to a particular situation.

#### **a. Volunteers**

Generally speaking a person is considered a volunteer if they perform services for an organization without any expectation of, or receipt of compensation for their services. Volunteers may be reimbursed for their reasonable expenses incurred in volunteering such as mileage or travel costs.

The federal and state wage and hour laws do not cover volunteers, meaning that you do not have to pay volunteers for their work. Volunteers may be paid for their volunteer-related expenses, reasonable benefits, a nominal fee, or any combination of these items for their services without losing their status as a volunteer. Benefits are considered reasonable when they involve such things as group insurance coverage maintained by the employer who performs the same services as the volunteers. Whether the fee received by a volunteer is nominal is determined by the economic realities of the total situation. Nominal fees cannot be substitutes for compensation and should not be tied to productivity.

Volunteers who are paid more than a nominal amount for their services are not volunteers. This amount has been set at \$100 or more per year under the Internal Revenue Code. If a volunteer is paid to perform some or all of the services they provide to the organization via wages, a stipend or flat fee unrelated to their reasonable expenses, they will be considered either an employee or independent contractor. It is probable they would be considered an employee for whom all the legal requirements must be met including payment of minimum wage and overtime for all hours worked, income tax withholding, social security tax contributions, workers’ compensation coverage and participation in benefit plans (ERISA).

#### **b. Employees**

Employees cannot volunteer to do the same jobs that they are paid to perform. In other words, if you have an employee who works as a vocational counselor during the day and you pay the individual hourly, that same individual could not volunteer her counseling services in the evening. If the volunteer duties of the employee are sufficiently different than her employment duties, however, the employee may volunteer. For example, a receptionist at a hospital was permitted to volunteer her services assisting patients after work because the duties involved were different.

An employer should make sure that any “volunteering” is truly voluntary, and, if the individual is an employee, avoid any implication that volunteering is a requirement of the job. An employer who has employees volunteering should make sure that:

The services are entirely voluntary (without contemplation of pay), there is no coercion to volunteer, and no penalty for not volunteering;

The activities are predominately for the employee's benefit;

The employee does not replace another employee while volunteering;

The activity does not take place during the employees' regular working hours; and

The volunteer time is insubstantial in relation to the employee's regular hours.

Whether using employee volunteers or regular volunteers, employers should strongly consider drafting a short form that the volunteer signs before he/she begins volunteering. The employee volunteer form should incorporate 1, 2, and 4 in the points listed above, and the non-employee volunteer form should include 1 above.

### **c. Independent Contractor or Employee**

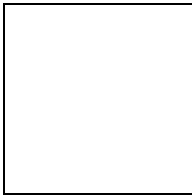
A person who performs services for an organization with an expectation or understanding he/she will be paid for his/her services is either an independent contractor or an employee. The tests for determining an individual's status vary according to the applicable law. Under federal law governing minimum wages and overtime, the Fair Labor Standards Act ("FLSA"), courts use an "economic reality" test to determine whether the worker is an employee. For most other purposes, such as income tax, withholding, courts apply the "right of control" test described below. While there are some persons who could be deemed employees for purposes of the FLSA but not for other purposes, such cases are rare.

i. Independent Contractor. A person who performs work for an organization with the expectation of being paid for such work will be considered an independent contractor if he/she does not meet any of the following tests for being an employee.

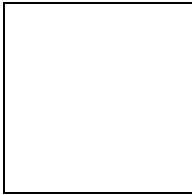
ii. Common Law Employee. The test for determining whether a worker is an employee for purposes of income tax withholding, social security tax contributions and ERISA coverage is whether the employer has “the right to control the manner and means by which the work is accomplished.”

An individual will be considered an employee when the person for whom he/she performs services has the right to control and direct the services, the result to be accomplished and the details and means by which that result is accomplished. It is not necessary that the employer actually direct or control the manner in which the services are performed; it is sufficient if the employer has the right to do so. If an individual is subject to the control or direction of another merely as to the result to be accomplished and not as to the means and methods for accomplishing the result, he/she is an independent contractor.

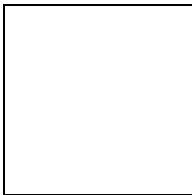
A court will consider the following factors in determining whether the “right of control” test is met:



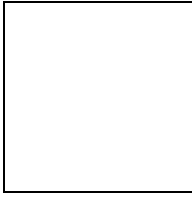
The skill required to perform the work. Workers performing highly skilled work are more likely to be considered independent contractors than workers performing comparatively low skilled work.



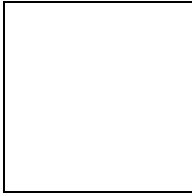
Who provides the tools and materials to accomplish the work. If the hiring party provides the tools and materials, this favors a conclusion the worker is an “employee.” If the worker provides his own tools and materials, this favors a conclusion the worker is an “independent contractor.”



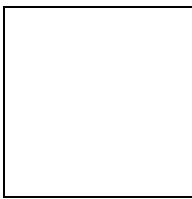
Whether the work is performed at the employer’s business. If a worker must perform the work at the hiring party’s place of business, this favors a conclusion the worker is an employee.



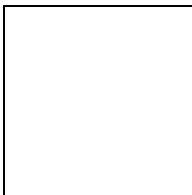
The duration of the relationship between the parties. The longer the duration of the parties' relationship, the more likely the worker will be considered an employee.



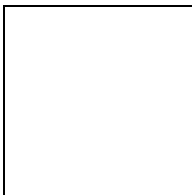
Whether the worker has the right to hire and pay assistants. If the worker cannot hire assistants to help, this sometimes supports a conclusion the worker is an employee.



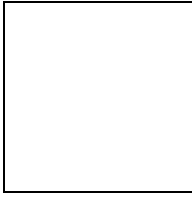
Whether the hiring party has the right to assign additional work to the worker. If the hiring party has the right (whether hiring party does so or not) to assign extra work to the worker, this supports a conclusion the worker is an employee.



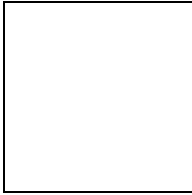
Method of payment. Payment by payroll check, payment on a salary basis, or payment for hourly work would tend to support a conclusion that the worker is an employee.



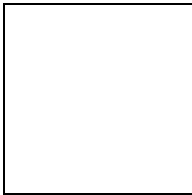
Whether the work is part of the regular business of the hiring party. If the nature of the work performed is part of the regular business of the hiring party, the worker performing such work is more likely to be considered an employee.



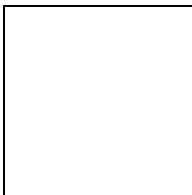
The extent of the worker's discretion over when and how long to work. The less discretion the worker has over when to work and how long, the more likely the worker will be considered an employee.



Whether the hired party is in business. A worker hired as an independent contractor who does not have any indicia of being in business (does not have a business license, tax ID number, etc.) is more likely to be considered an employee.



Whether the worker receives employee benefits. If a worker receives benefits usually given to employees, the worker is more likely to be considered an employee.



How the parties treat the worker for tax purposes. How the parties themselves characterize their relationship is relevant, but not a controlling factor. If the facts otherwise indicate the worker is an employee, an agreement between the parties to the contrary is not sufficient to alter the employee's status.

The "right of control" test requires all of these factors to be considered and weighed. No one factor is decisive and there is no short hand formula or magic phrase that can be applied to find the answer. After considering all of these factors, if a person is not found to be an employee, he/she will be considered to be an independent contractor.



### **3. Statutory Employees**

Certain workers are deemed to be employees as a matter of law even if they might not otherwise meet the “right of control” or “economic reality” tests discussed above. Such employees are termed “statutory employees.” An individual may be a statutory employee under different laws for different purposes. For example, officers of a corporation, home workers, and certain traveling or city sales-men are considered statutory employees for whom certain employment taxes must be withheld and paid.

## **D. Obligations of an Organization with Respect to Employees**

### **1. Federal Requirements**

#### **a. FEIN**

All employers must obtain a Federal Employer Identification Number (“FEIN”) that will be used when filing applicable tax returns. Internal Revenue Service Form SS-4 is used to request a FEIN.

#### **b. IRCA**

All employers are required to verify that an employee is eligible to work in the United States. U.S. Department of Justice, Immigration and Naturalization Service Form I-9 “Employment Eligibility Verification” must be completed for each employee and maintained on file by the employer.

#### **c. Federal Income Tax Withholding and Social Security Contributions**

Employers are required to pay Social Security and Medicare taxes (commonly referred to as “FICA taxes”) on income paid to their employees. Beginning In 1999, the employer was required to pay 6.2% in Social Security tax and 1.45% in Medicare tax on each employee’s gross earnings (up to specified amounts). The employee must contribute the same amount.

The employer is required to deduct from each employee’s wages, the employee’s share of social security taxes and the correct amount of income tax to be withheld. To determine the appropriate amount of income tax to withhold, the employee must fill out a Form W-4 to indicate their filing status and the number of deductions they claim.

An employer must deposit the income taxes and FICA taxes it has withheld from the employee, along with the employer’s share of the FICA taxes, with the Internal Revenue Service. Depending on the size of the employer’s payroll, these deposits must be made either on a next day, semi-weekly, monthly or quarterly basis. Most small organizations will make deposits monthly or quarterly. Deposit slips are provided by the IRS after the employer has requested an FEIN and indicated it will be employing employees. It is extremely important to properly withhold and timely deposit the employee’s and employer’s share of taxes owed. Failure to make such deposits will subject the employer to civil fines and penalties, and possibly criminal liability.

In addition to making the required deposits, each quarter the employer must complete a federal tax return showing the amounts withheld and deposited. This tax return, called a Form 941, must be timely completed and filed with the IRS. Failure to file the form or late filing will result in civil penalties.

#### **d. Federal Unemployment Taxes (“FUTA”)**

Employers also are required to pay federal unemployment taxes for each employee. The employer pays the full amount of this tax and may not deduct any portion of the tax from his employee’s wages. FUTA taxes must be deposited with the IRS quarterly, but only when the amount exceeds \$100. If an employer’s FUTA tax liability is less than \$100 per year, the tax is paid when the annual return is filed. In addition to depositing the FUTA taxes owed, employers must file an FUTA tax return called a Form 940. Form 940 is filed annually even if the taxes are deposited more frequently. 501 (c)(3) organizations are exempt from payment of Federal Unemployment Taxes.

## **2. State Requirements**

#### **a. State and Local Business Licenses**

In Washington, employers must complete a Master License Application (“MLA”) with the State of Washington. A MLA packet can be obtained from the State Department of Licensing. The application allows an employer to obtain a business license and register with all state agencies for which registration is required including Employment Security Department (“ESD”) for unemployment insurance and the State Department of Labor and Industries (“DLI”) for worker’s compensation insurance. After the MLA is completed, the employer will receive a unique “UBI” number (Unified Business Identifier number). This is the number that identifies the employer to the State. The employer must use this number when completing quarterly reports to the DLI and ESD. Typically, an employer obtains an FEIN before submitting its MLA. However, a new program of the DLI allows first time applicants to apply for an FEIN when they apply for a UBI number.

If you already have a UBI number but are hiring employees for the first time, you must submit another MLA and indicate it is being submitted because you are hiring employees. In this situation, you will not receive a new UBI number but will be registered with the appropriate state agencies.

Depending on the nature of the organization’s activities, an employer may also need to register with the city or county in which it is conducting its business.

#### **b. Worker’s Compensation**

Completing the MLA will notify the DLI that the organization plans to hire employees. DLI administers Washington’s Industrial Insurance program which is a system of mandatory insurance that provides employees who are injured or become ill as a result of their employment with medical insurance, salary continuation payments, vocational rehabilitation services and compensation

payments for permanent partial or permanent total disability. All employers are required to participate in the industrial insurance or “worker’s compensation” system.

With very narrow exceptions, the worker’s compensation system is the sole remedy available to covered workers who are injured or become ill in the course their employment. In exchange for giving up their right to sue the employer for damages resulting from an industrial injury or illness, the Industrial Insurance Act guarantees employees coverage for work-related injuries or illnesses; with limited exceptions.

The worker’s compensation system is managed in two ways. Most employers participate in the state run insurance system. Larger employers sometimes insure themselves.

### **c. State Workers’ Compensation**

Employers who participate in the state insurance program pay a tax based on the number of hours worked by their employees, the risk of injury or illness inherent in the jobs being performed, and the employer’s “claims experience” rating.

A “self insured” employer is responsible to pay all costs associated with self-administering the insurance program and all costs of providing care for an injured employee, including medical expenses, payment of a portion of employees’ wages when they are unable to work, and vocational rehabilitation costs. A “self-insured” employer is required to provide the same benefits and due process as are available to employees under the state insurance program. In the event of a serious injury, the cost to an employer of self-insuring can be very significant.

Self-insurance is not recommended for small employers and might not be approved by the State. Special application is required in order to become self-insured. Self-insurance should be undertaken only as part of a comprehensive risk management plan.

Once an employer indicates in its MLA that it will have employees, the employer will receive a form from DLI indicating the tax rate that will apply to its employees. The tax rate is based on the rate of injuries or illness reported for each particular job category. The more dangerous a job, the higher the tax rate. Overtime employer tax rates are also based on the employer’s individual claims rate. Employers with more industrial injuries or illnesses will receive a higher “experience rating” and therefore pay higher taxes.

Each quarter, the employer must complete and submit a report to DLI listing its employees and their hours worked. The employer must pay a tax calculated by multiplying the total hours worked by the tax rate. The report and appropriate tax payment must be submitted to DLI by the due date or automatic penalties will be imposed.

Most of this tax cannot be passed on to the employee. There is a small portion of the tax that relates to medical expenses which may be passed on to employees. Small employers may find the record keeping involved in making such allocation not worth the small savings.

To receive benefits under the worker's compensation system, an employee who suffers an industrial injury or illness is required to complete an accident report form provided by DLI. These are usually available from the employee's doctor or can be requested from DLI. Once the employee and employee's doctor have completed the report, the employer will receive a copy from DLI and be asked to complete the employer's portion of the report. The employer has an opportunity at this point to indicate whether it agrees or disagrees that the worker suffered an injury or illness connected to their employment. Once DLI has received the completed form, it will decide whether to allow the claim or deny it. If allowed, the claim will be opened and the worker will receive benefits to which he/she is entitled. These may include payment of medical bills, wage loss, disability and/or rehabilitation expenses.

#### **d. Unemployment**

Washington State has an Employment Security insurance program (commonly referred to as "unemployment insurance"). Employees who become unemployed through no fault of their own are entitled to receive unemployment compensation, provided they have worked enough hours during the year they are seeking benefits or the year immediately preceding it. Employees who quit their jobs without good cause are not entitled to benefits. It is often incorrectly believed that an employee who is fired from their job is not entitled to unemployment compensation. An employee who is discharged for misconduct connected with his or her work is disqualified from receiving unemployment benefits, but only if the employee's act or failure to act was in willful disregard of his or her employer's interests and the effect of the employee's act or failure to act is to harm the employer's business. The Legislative intent of the statute is to ensure that the unemployment benefits are not denied unless the employee's conduct was both willful and harmful to the employer. This is a difficult standard to meet in discharge cases and discharged employees frequently are entitled to unemployment benefits.

Each employer must provide unemployment insurance for its covered employees. As with Industrial Insurance, unemployment insurance rates are based on a complex formula that takes into consideration both the number of unemployment claims paid in the State and the employer's own rate of claims. Like the Industrial Insurance tax rate, if an employee receives unemployment benefits, the employer's unemployment tax rate will increase.

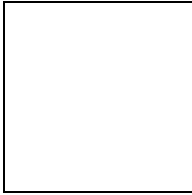
Under state law, nonprofit organizations have the option of self-insuring the cost of providing such benefits. Given the relatively nominal cost of participating in the State unemployment insurance program, and the high cost of directly paying unemployment benefits, it is probably not cost effective for an organization to self insure.

Once an employer indicates in its Master License Application that it will have employees, the employer will receive a form from the State Employment Security Department (ESD) indicating the tax rate that will apply to its employees. Each quarter, the employer must complete and submit a report to ESD listing its employees, the hours they worked and the wages or salaries they were paid. The employer must pay a tax calculated by multiplying the total payroll amount by the tax rate.

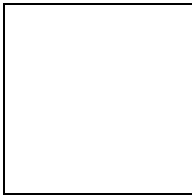
This tax cannot be passed on to the employee. The report and appropriate tax payment must be submitted to ESD by the due date or automatic penalties will be imposed.

### 3. Wage and Hour Law

Wage and hour law is an expansive topic with which all employers should have some familiarity. Keys traps for the nonprofits include the following:



Not paying employees for required functions. You cannot require non-exempt employees to attend after-hour meetings or fundraising events without paying them. Employees must be compensated for all job functions that they are required to attend.



Failing to classify employees properly. Federal and state wage and hour laws contain provisions concerning minimum wages, equal pay, and overtime pay for work exceeding 40 hours during a workweek, record keeping, and child labor. Some employees are excluded from federal and state minimum wage or overtime provisions, or both. Employers often mischaracterize employees. Whether an employee is exempt depends on their actual job functions, not their job titles.

Simply calling someone a Manager does not make him or her exempt.

Unless an employee is exempt from coverage of wage and hour laws, state and federal law requires employers to pay employees a specified minimum wage and overtime at one and a half times the employee's regular rate for all hours worked in excess of 40 hours per week. Presently, the state minimum wage in Washington State is significantly more than the federal minimum wage. The State minimum wage was increased to \$6.50 per hour beginning January 1, 2000. Beginning on January 1, 2001, the minimum wage will be increased annually based on the rate of inflation.

State law permits employees to request compensatory time off in lieu of overtime payments. If an employee requests compensatory time, the law permits the employer to grant such compensatory time and does not require the employer to pay overtime. Compensatory time must be awarded at a rate equal to one and a half times the regular hourly rate of pay. Although the issue has not been decided, it is likely an employer may not require employees to accept compensatory time in lieu of overtime.

Federal law does not permit payment of compensatory time for private employers. Thus, if an organization is covered under the Fair Labor Standards Act, it may not grant compensatory time in lieu of payment for overtime, even if requested to do so by the employee. There continues to be discussion at the federal level about changing the FLSA to permit the use of compensatory time so this rule could change at any time.

Some employees are exempt from state and federal wage laws. Employers are not required to pay exempt employees overtime or minimum wage. There are numerous specific exemptions set out in the state and federal laws for particular types of employment and industries that will not be addressed here. There are three general exemptions covering administrative, executive and professional employees that commonly arise with respect to nonprofit organizations. Whether or not an exemption applies is determined by the nature of the employee's job duties. If the employee's duties fall within the exempt definition, the employee will be exempt from overtime and minimum wage requirements regardless of the employee's job or industry. It is recommended that you seek the advice of a lawyer with respect to the particular circumstances in your organization.

## **E. Obligations of an Organization With Respect to Independent Contractors or Volunteers**

### **1. Federal Income Tax**

An organization is not required to and should not withhold or pay employment taxes on independent contractors (except as provided in the discussion on workers' compensation below). An organization that uses the services of an independent contractor is only required to provide the independent contractor with a Form 1099 showing the amounts paid to the contractor. A copy of this form also must be filed with the Internal Revenue Service. Form 1099 must be provided to each independent contractor and copies filed with the Internal Revenue Service following the close of each year. For the following reasons, it is very important to provide Form 1099 to each independent contractor and to file the required return in a timely manner.

In certain circumstances, the Internal Revenue Code creates a "safe harbor" for employers in the event the IRS determines the employer incorrectly classified persons as independent contractors when they should have been characterized as employees. This "safe harbor" effectively eliminates an employer's liability for improperly characterizing an individual as an independent contractor rather than an employee.

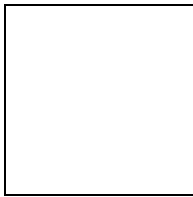
If an employer incorrectly treated an individual as an independent contractor instead of an employee for any period, the law requires the IRS to deem the individual to be an independent contractor unless the employer had no reasonable basis not to treat the individual as an employee. However, this "safe harbor" applies only if all tax forms required to be filed for such individual have been filed in a timely manner, all forms filed for such individual characterize the individual in the same way (the employer has always issued the individual a 1099 Form, for example) and the employer has treated all persons holding substantially similar positions the same way. If the employer fails to

file the forms as required, or sometimes files a 1099 for the individual and other times files a W-2, or characterizes similarly situated individuals differently, the safe harbor will not apply.

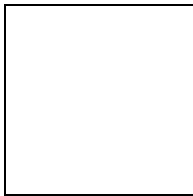
## **2. Workers Compensation**

### **a. Independent Contractors**

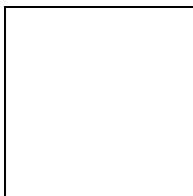
Unless exempt under State law, an organization is required to cover independent contractors for worker's compensation purposes. An employer may exclude independent contractors from workers compensation coverage only under certain circumstances. An employer must pay industrial insurance premiums for independent contractors it hires where the essence of the work is personal labor. If the nature of the work is personal labor, an employer may still avoid paying worker's compensation taxes on an independent contractor if the contractor meets all of the following criteria:



The worker must be free from the direction and control of the employer both by contract and in fact.

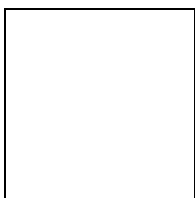


At least one of the following applies: The services performed are outside the usual course of business of the employer; or the services are performed outside all places of business of the employer; or the person performing the services must by contract and in fact, be responsible for the costs of the principal place of business where the service is performed.

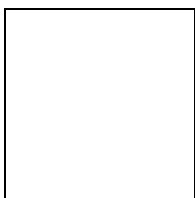


The worker must be customarily engaged in the business for which he/she is performing services.

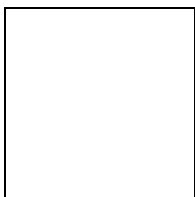




The worker is responsible for filing his/her own business and employment tax returns with the Internal Revenue Service.



The worker has a business license and is otherwise licensed and registered with all state agencies requiring registration or license.



The worker maintains a separate set of books reflecting income and expenses for his/her business.

If a worker does not meet each of these tests, then he/she will be considered a covered worker under the industrial insurance law and the employer will be required to make appropriate industrial insurance tax contributions based on the worker's hours of employment with the employer.

#### **b. Volunteers**

Under state law, a non-profit organization may choose to cover its volunteers. If a nonprofit organization elects to cover volunteers, it must cover all volunteers and give notice of its intention to the Director of the Department of Labor and Industries prior to the occurrence of an injury or occupational illness in order for the injury or illness to be covered. The organization must then pay a tax based on the number of hours worked by each volunteer and the nature of their volunteer job activities.

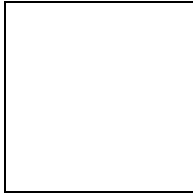
### **F. Record Keeping Requirements**

Under Washington law, employers must keep and preserve certain payroll and other records for all employees. These required records are the employee's name, address, and occupation, rate of pay, and amount paid each pay period to each such employee, the hours worked each day and each workweek by such employee.

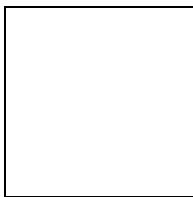
In addition to records that must be kept for all employees, employers must kept additional records for employees subject to State minimum wage and overtime laws. Records for employees subject



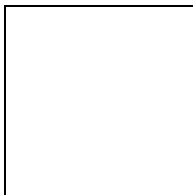
to minimum wage and overtime requirements must contain the following information for each and every employee and must be kept for at least three years:



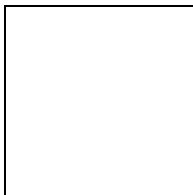
Name in full, and on the same record, the employee's identifying symbol or number if such is used in place of name on any time, work or payroll records. The employee's name must be the same name as that used for Social Security record purposes;



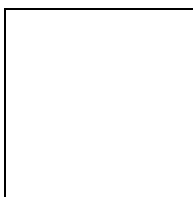
Home address;



Occupation in which employed;



Date of birth if under 18;



Time of day and day of week on which the employee's workweek begins. If the employee is part of a workforce or employed in or by an establishment all of whose workers have a workweek beginning at the same time on the same day, a single notation of the time of the day and beginning day of the workweek for the whole workforce or establishment will suffice. If, however, any employee or group of employees has a workweek beginning and ending at a different time, a separate notation shall then be kept for that employee or group of employees;

Hours worked each workday and total hours worked each workweek  
(for purposes of this section, a “workday” shall be any consecutive 24 hours);

Total daily or weekly straight-time earnings or wages; that is, the total  
earnings or wages due for hours worked during the workday or workweek, including  
all earnings or wages due during any overtime worked, but exclusive of overtime  
excess compensation;

Total overtime excess compensation for the workweek; that is, the  
excess compensation for overtime worked which amount is over and above all  
straight-time earnings or wages also earned during overtime worked;

Total additions to or deductions from wages paid each pay period.  
Every employer making additions to or deductions from wages shall also maintain a  
record of the dates, amounts and nature of the items which make up the total  
additions and deductions;

Total wages paid each pay period; and

Date of payment and the pay period covered by payment.

Such records must be kept for a period of at least three years.

## **G. Payment of Wages**

Employees must be paid at least monthly on established regular paydays. An employer may implement a regular payroll system in which wages from up to seven days before payday may be withheld from the pay period covered and included in the next pay period.

When an employee stops working for an employer, for whatever reason, the employer must pay the employee the wages due him no later than the end of the established pay period. An employer may not withhold or divert any portion of an employee's wages unless the deduction is:

Required by State or federal law; or

Specifically agreed upon orally or in writing by the employee and employer; or

For medical, surgical or hospital care or service, pursuant to a rule or regulation.

Any such deductions must be openly, clearly recorded in the employer's books and records at the time made.

## **H. Employee Handbooks**

### **1. Should You Have One?**

An employee handbook is a compilation of policies and procedures which an employer decides it wants to use in running its business and wishes to communicate to its employees. There are many positive reasons to have an employee handbook and few negative ones provided the handbook is properly written. An employee handbook allows you to communicate policies and procedures in a comprehensive and consistent way. It helps to ensure that all employees receive copies of important policies such as sexual harassment policies. Having employees sign a receipt for the handbook provides an efficient method to document employee receipt of all pertinent policies and procedures.

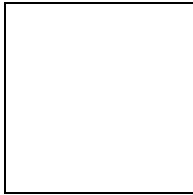
There is one significant concern about having an employee handbook. In Washington, unless otherwise agreed by the employer and employee, all employees are considered to be “at will” employees. This means the employee may resign at any time for any or no reason and the employer may discharge the employee at any time for any or no reason. In other words, an employer does not have to have a reason to discharge an “at will” employee. Courts have held that in certain limited circumstances an employee handbook could create a contract between the employee and employer that might prevent the employer from discharging the employee except for reasons set out in the handbook.

### **2. Preserving the “At Will” Employment Relationship**

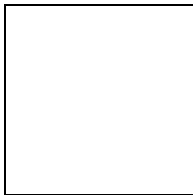
To preserve the “at will” employment relationship, employee handbooks should not promise employees specific treatment in specific circumstances. Such handbooks should not state that employees may be discharged or disciplined only “for cause” or “just cause” or after a certain process or procedure. The handbook should not give any guarantee of employment such as by stating or suggesting that employment is “permanent,” “guaranteed,” or for any particular period of time. Each employee handbook should contain a prominent disclaimer that states that the employee expressly agrees and understands that the employee handbook and all provisions in the handbook are general guides and are not a contract or an assurance of continued employment. The disclaimer should include a statement that the employee acknowledges and understands that his employment is at will. The disclaimer should define the term “at will.” The disclaimer should also state that the employee understands the employer may change the handbook and its provisions at any time. If there was a previous handbook or set of policies, the disclaimer should state that such handbook is no longer in effect. Finally, it should be expressly stated which management person has the authority to change an employee’s at will status and that this may only be done by specific written agreement. It is recommended that an employer have each employee read and sign the disclaimer including the date of signature.

### 3. Matters to Include in an Employee Handbook

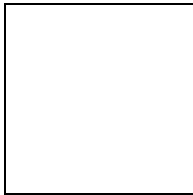
The following matters are suggested employer policies and procedures to include in an employee handbook:



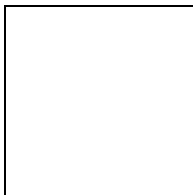
Employment is “at will” status.



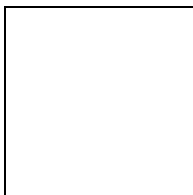
Equal employment/non-discrimination policies.



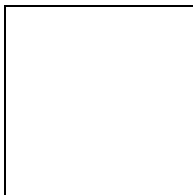
Sexual harassment policy and specific complaint procedures.



Policies relating to Americans with Disabilities Act and/or State Law  
Against Discrimination.



Work hours, lunch period, rest breaks, flextime policies.



Overtime eligibility, authorization and reporting.

Compensatory time policy (if permitted by law).

Policies and procedures relating to use of vacation, sick leave, bereavement leave, military leave, jury duty, etc.

Procedures for using family and medical leave (if applicable).

General employee conduct policies including: attendance, use of alcohol and drugs, non-exclusive examples of conduct that may result in discipline, and non-exclusive examples of the types of discipline that may be imposed.

Performance appraisals.

General descriptions regarding the availability of employee benefits (medical and dental insurance, life insurance, disability insurance and retirement plans).

Holidays that are observed.

Safety policies.

Emergency procedures.

Employee use of employer e-mail and Internet access.

Employee use of employer phones and other equipment.

Procedures on termination of employment (advance notice of voluntary quit, COBRA procedures and coverage upon termination of employment (if applicable), and procedures and eligibility for state benefits such as unemployment and worker's compensation)

## CHAPTER VI Financial and Other Issues

### A. Washington Charitable Solicitations Act

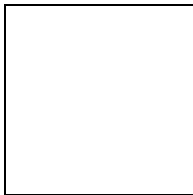
Section A Authored by: [David Horn](#), Assistant Attorney General for the State of Washington

#### 1. Compliance

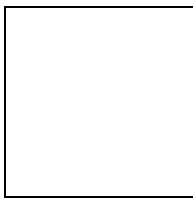
This outline is intended to be a summary that will help nonprofits and fundraisers understand the laws applicable to charitable solicitation in Washington. It is not complete and is not an official interpretation of the statute or the rules. Reading it should not be considered an acceptable substitute for seeking legal counsel wherever it may be appropriate to do so.

The Charitable Solicitations Act (“CSA”) is the Washington State statute that regulates the activities of persons and firms who raise money from the public for charitable purposes or what they say are charitable purposes. The CSA is located in the Revised Code of Washington, chapter 19.09.

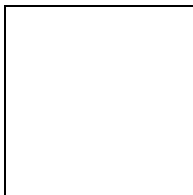
The CSA requires that charitable organizations and commercial fundraisers:



Register and annually report;



Make required disclosures; and

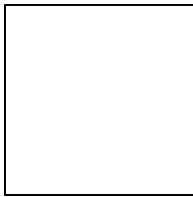


Do not mislead contributors.

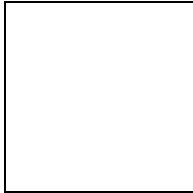
The CSA applies to almost every person or organization that conducts charitable solicitations in the state. This includes those who make telephone calls or send letters or e-mail into Washington from outside the state—or, for that matter, from within the state. It also includes those who solicit contributions from persons in Washington via a website. See Section 2.a. below for a more detailed discussion of website solicitation.



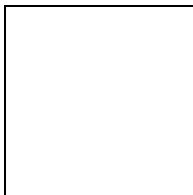
Specifically, the Act includes three kinds of persons or organizations:



Charitable organizations;



Commercial fundraisers; and



Commercial co-venturers.

A charitable organization is any person or entity that conducts charitable solicitations — that is, solicitations for contributions, or for purchase of a good or service, in which an appeal is made for a charitable cause. Commercial fundraisers, however, are not considered charitable organizations.

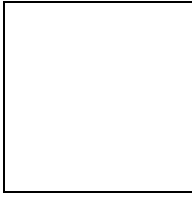
A commercial fundraiser is a firm that is in the business of conducting charitable solicitations on behalf of others in exchange for compensation. Most commercial fundraisers use either telephone solicitation or direct mail, and most of them raise money for several different charitable organizations. Commercial fundraisers are regulated by the CSA along with charitable organizations.

A commercial co-venturer is a retail establishment that is not otherwise engaged in charitable solicitation, but decides to run a special promotion to benefit a charitable cause. Such promotions qualify as commercial co-venturing only if the co-venturer (a) tells consumers that a specified portion of the sales price or a certain sum of money will be donated to a named charity, and (b) asks the consumers to make their payment directly to the coventurer rather than to the charity. This includes, for example, a restaurant that advertises, “Buy a Burger from us and we’ll give five cents to the Friends of the Wilderness.”

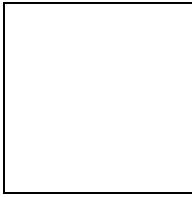
## **2. Solicitations**

### **a. Definitions**

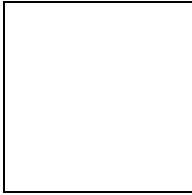
A charitable solicitation is:



Any appeal to the public for a contribution in which an appeal is made for a charitable cause; or

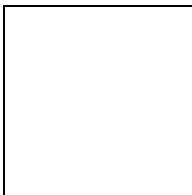


Any appeal to the public for a contribution in which an appeal is any charitable purpose.

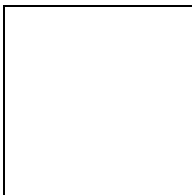


Any offer or attempt to sell a good or service in which (1) an appeal is made for a charitable cause; or (2) the name of a charitable organization is used to help secure a sale; or (3) it is stated or implied that all or part of the proceeds will benefit some charitable purpose.

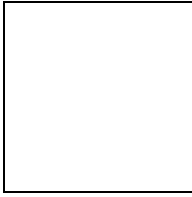
Charitable causes include, but are not limited to, educational, recreational, social, patriotic, legal defense, benevolent, and health causes. Activities that are "political" or "religious" are not charitable and are not covered by the CSA. Examples of charitable solicitations include:



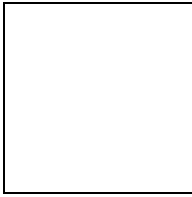
A letter that says, "Please give to the YMCA's annual clothing drive."



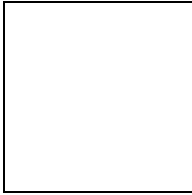
A telephone call in which the caller says, "Please give to the United Way."



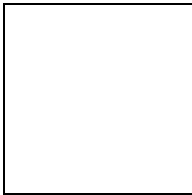
A telephone call in which the caller says, "Please buy a ticket to the police football game to benefit the police association and help troubled youth."



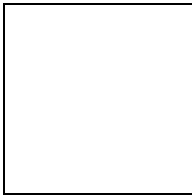
An e-mail message in which the writer says, "Please buy these light bulbs to help the disabled."



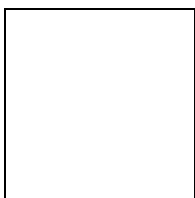
A door-to-door solicitation in which a youth says, "Buy this candy from me and it will help keep kids off drugs and out of gangs." Note: This remains a charitable solicitation even if the youth holds up a sign saying, "This is not a charity."



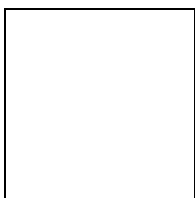
A website or e-mail message that describes a program to help the homeless and tells how the reader can make a contribution.



A telephone call in which the caller says, "We are having a party and inviting disabled children, and we need funds to provide entertainment and pay for the children's transportation and lodging."



A sign posted in a retail store that says, “Buy stuff here to help the veterans” or “For every item you buy, we’ll give a penny to a homeless shelter.”



A telephone call in which the caller says, “Buy a ticket to our circus and the proceeds will provide benefits to families of police officers killed in the line of duty.” Note that for purposes of the law, this is still a charitable solicitation even if the solicitor is lying and planning to keep the money for himself.

If you conduct a charitable solicitation, you are considered a "charitable organization" for purposes of this statute even if you do not think of yourself as a charity. This is true even if you are a for-profit corporation or other form of business, such as a sole proprietorship or partnership, or simply an association of people. It is also true if you are a nonprofit corporation that is not usually thought of as a "charity." A police or firefighter union is considered a charitable organization if it engages in charitable solicitation, such as asking the public to buy tickets to an event to benefit police or firefighters.

By the same token, your organization might be a well-established charitable foundation that gives money away all day long, but if it does not solicit contributions, it may not qualify as a charitable organization under the CSA and may not be required to register. Note that such an organization will still need to comply with Washington State laws relating to charitable trusts. See Section B below for a discussion of the Washington Charitable Trust Act.

Those who use a website or email to solicit contributions from persons in Washington must also register. Of course, it may not be immediately obvious whether a particular website is intended to solicit money from Washingtonians. At a minimum, if an organization’s website requests or accepts contributions from persons in Washington, or indicates it performs services here, or has some other connection to the state, then that organization must register. For instance, a group that operates or solicits nationally, and uses its website actively to solicit contributions from across the country, must register in Washington — unless it does not accept contributions from persons in Washington and clearly says so on its website. By contrast, the Charleston High School PTA in Charleston, South Carolina would not normally be expected to register in Washington State just because it has a passive website that can be seen by persons in Washington. Notwithstanding these distinctions, those who maintain a misleading website that deceptively draws contributions from Washington are subject to enforcement action by the attorney general — even if they are not required to register here.

### **3. Exemptions**

#### **a. Grant Applications and Gambling Activities**

Grant applications are not charitable solicitations and are not covered by the CSA.

Gambling activities such as raffles, bingo and "amusement games" that are regulated by the Gambling Commission are not subject to the CSA.

#### **b. Political Activities**

Requests for political contributions are not charitable solicitations and are exempt from the CSA. "Political" means activities that are subject to regulation under state or federal election laws. The political exemption applies only if the solicitation is political, that is, if it is for a candidate, ballot measure or lobbying effort, or if contributors are actually told the money will be used for political purposes. If, instead, the funds are raised through an appeal to a charitable cause, such as support for a police or firefighter organization, then the solicitation is a charitable solicitation, and the organization must register and comply accordingly ? even if the money ends up being used for politics.

#### **c. Religious Activities**

Fundraising to support religious causes is exempt from the CSA. To be entitled to this exemption, the religious organization must be eligible for recognition by the Internal Revenue Service as a Section 501(c)(3) tax-exempt religious organization. Other forms of 501(c)(3) organizations are not exempt from the CSA.

#### **d. Fundraising Counsel**

Fundraising counsel are exempt from registering in Washington. Fundraising counsel are persons or firms that are in the business of advising others how to conduct charitable solicitations, but do not directly or indirectly solicit or receive contributions. (Note that the statute does not actually use the term "fundraising counsel.") In recent years some commercial fundraisers have claimed erroneously that they are merely fundraising counsel and need not register, even though they have entered into contracts that call for them to raise money for charitable organizations or arrange for it to be raised. A firm that is in doubt as to its status should consult an attorney.

#### **e. Membership Solicitations**

Organizations that solicit only from their members are exempt. They are exempt only if the membership is a real membership, not something fabricated so the organization does not have to register under the CSA. The statute states, "'Membership' means that for the payment of fees, dues, assessments, etc., an organization provides services and confers a bona fide right, privilege, professional standing, honor or other direct benefit, in addition to the right to vote, elect officers or hold office. The term 'membership' does not include those persons who are granted a membership upon making a contribution as the result of solicitation."

## 4. Registration

### a. Who Must Register?

Everyone—charitable organization, commercial fundraiser or commercial co-venturer—who conducts charitable solicitations in Washington, must first register with the Secretary of State. This includes those who solicit into Washington from out of State. It includes those who solicit both by traditional means — door-to-door, telephone and direct mail—and via the Internet. Anyone who solicits by e-mail sent into Washington must register here. In addition, one who posts a website that solicits contributions is expected to register, especially if the website mentions facilities or services in Washington or nationally, or a desire to receive contributions from Washington or nationally, or if for some other reason the organization receives contributions from persons in Washington.

### b. Exemptions

All the persons and organizations that are entirely exempt from the CSA are of course exempt from registration. In addition, the CSA exempts from registration those charitable organizations that:

Raise less than \$25,000 per year;

Do not hire a commercial fundraiser; and

Do not pay any officers, employees, fundraisers, contractors or anyone else any money or other compensation for performing services. Any charitable organization that retains a commercial fundraiser or pays any compensation to any officer, employee or agent must register, no matter how little money it raises.

### c. Forms

There are three ways to register under the CSA: as a charitable organization, as a commercial fundraiser, and as a commercial co-venturer. There is a different form for each of these three kinds

of organizations. Forms may be obtained from the Secretary of State's Office. The Secretary of State also permits an exempt organization, such as a church, to file an optional Statement of Exempt Organization. This allows the Secretary to provide information about such a group to inquiring consumers.

If a charitable organization is going to use a commercial fundraiser to solicit, it must also have a written contract with the fundraiser. The contract must:

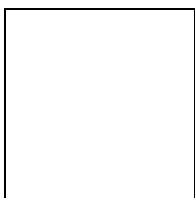
Require both parties to comply with the law.

Permit officers of the charitable organization reasonable access to the fundraisers' financial records relating to that charity and its operations, including any telephone solicitation rooms.

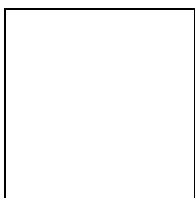
Specify the amount of raised funds that the charitable organization will receive or the method of computing that amount, the commercial fundraiser's compensation or the method of computing it; and whether the compensation is fixed or contingent.

The charitable organization and the commercial fundraiser must file a copy of that contract with the Secretary of State before beginning to solicit. In addition, most commercial fundraisers must obtain and file a surety bond in the amount of \$15,000. A copy of the bond must be filed with the Secretary of State. Commercial fundraisers need to file a bond if any of the following four conditions is met:

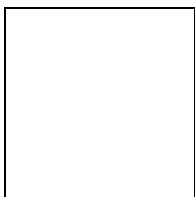
The fundraiser either directly or indirectly receives contributions from the public on behalf of any charitable organization;



The fundraiser is compensated based upon funds raised or to be raised, number of solicitations made or to be made, or any other similar method;



The fundraiser incurs or is authorized to incur expenses on behalf of the charitable organization; or



The fundraiser has not been registered with the Secretary as a commercial fundraiser for the preceding accounting year.

A commercial co-venturer must file an abbreviated registration with the Secretary of State but need not post a bond nor file a copy of the contract between itself and the charitable organization for which it is soliciting.

#### **d. When to Register**

You must register before you begin soliciting. If you are already registered, you need to renew your registration before the 15th day of the 5th month after the end of your accounting year. If your accounting year is January through December, your renewal is due on May 15. If it is July through June, it is due on November 15.

If you fail to register and nonetheless solicit, you are committing a violation of the CSA. This creates a risk that the Attorney General's Office may take legal action against you.

### **5. Rules of Solicitation**

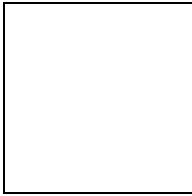
#### **a. Required Disclosures**

##### **i. By a Commercial Fundraiser.**

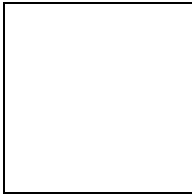
The following disclosures must be made by a commercial fundraiser at the point of solicitation. If the solicitation is made by telephone, these disclosures must be made during the call, before asking for a contribution. They must also be made in writing within 5 days to any person who responds to



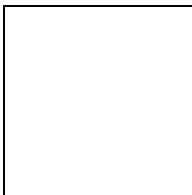
the solicitation by making a pledge. If the commercial fundraiser sends any materials to the person solicited before his or her contribution has actually been received, those materials must include these disclosures.



The name of the individual making the solicitation.



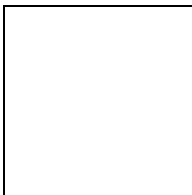
The full name of the commercial fundraiser (i.e., the name of the firm for which the solicitor works) and the name and city of the charitable organization for which the solicitation is being conducted.



If requested, the Secretary of State's toll free number for charities information (1-800-332-4483 or 1-800-332-GIVE).

## ii. By a Charitable Organization

If a charitable organization is making solicitations directly, instead of through a commercial fundraiser, the following disclosures must be made by the charitable organization at the point of solicitation. If the solicitation is made by telephone, these disclosures must be made during the call, before asking for a contribution. They must also be made in writing within 5 days to any person who responds to the solicitation by making a pledge. If the charitable organization sends any materials to the person solicited before his or her contribution has actually been received those materials must include these disclosures.



The name of the individual who is making the solicitation.

The identity of the charitable organization and the city where its principal place of business is located.

If requested, the Secretary of State's toll free number for charities information (1-800-332-4483 or 1-800-332-GIVE).

iii. By Anyone Soliciting by Advertisement or Mass Distribution.

This category includes anyone soliciting by advertisement, or by posters, leaflets automatic dialing machines, publication, and audio or video broadcast. This kind of solicitation must disclose clearly and conspicuously that:

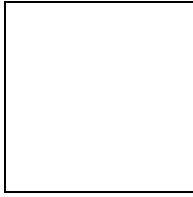
The solicitation is conducted by a named commercial fundraiser, if it is.

The entity conducting the solicitation is registered with the Secretary of State's Office.

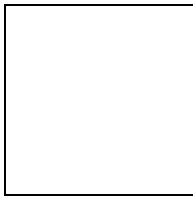
Additional information can be obtained by calling 1-800-332-GIVE.

iv. By Anyone Using Containers or Vending Machines to Solicit

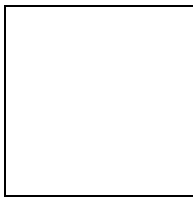
Any container or vending machine that displays a solicitation must also display the following in a clear and conspicuous manner:



The name of the charitable organization for which funds are solicited.



The name, residence address, and telephone number of the individual and any commercial fundraiser responsible for collecting funds placed in the containers or vending machines.



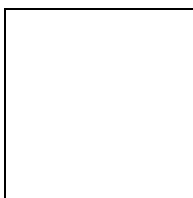
The following Statement: "This charity is registered with the Secretary of State's Office under the charitable solicitations act, registration number ."

v. **By Persons Soliciting for Organizations Whose Names Sound Like a Unit of Government**

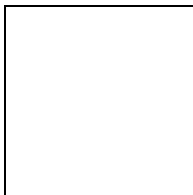
"If the charitable organization is associated with, or has a name that is similar to, any unit of government each person or organization soliciting contributions shall disclose to each person solicited whether the charitable organization is or is not part of any unit of government and the true nature of its relationship to the unit of government." This does not apply to a foundation organized, operated or controlled by the registered public charity from which it draws its name.

**b. Prohibited Statements**

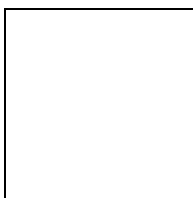
The following Statements or representations are prohibited:



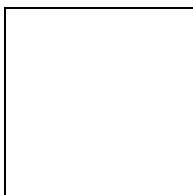
That contributions are tax deductible, unless the IRS has written a letter granting tax deductible status to the charitable organization, and the charitable organization has filed a copy of that letter with the Secretary of State.



That the caller or solicitor is a volunteer. Note that the law prohibits any use of words that implies that the solicitor is anything other than a paid solicitor, unless of course the solicitor is actually a volunteer.



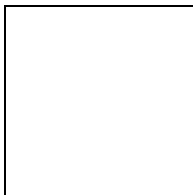
That the solicitor is “a member, staff, helper, or employee of the charitable organization or words of a similar meaning or effect that create the impression that the person soliciting is not a paid solicitor if the person soliciting is employed, contracted, or paid by a commercial fund raiser.”



Any false, misleading or deceptive statement.

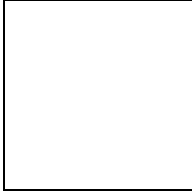
c. Additional Requirements

Charitable organizations and commercial fundraisers must abide by the following additional requirements:

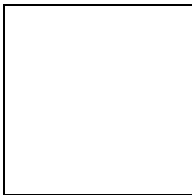


Solicitors may not use the name “police,” “sheriff,” “fire fighter,” “firemen” or similar name unless properly authorized by a bona fide police, sheriff, or firefighter organization or police, sheriff or fire department. Authorization must be

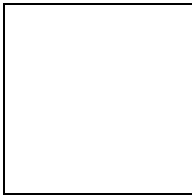
in writing, signed by two authorized officials and registered with the Secretary of State.



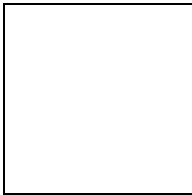
Solicitors may not use the name of a federally chartered military veterans' organization unless authorized in writing by the highest-ranking official of that organization in this state.



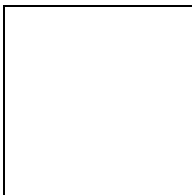
Solicitors must comply with all local government regulations; it is a violation of state law not to do so.



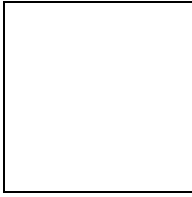
Solicitors may not use or exploit the fact that they are registered with the Secretary of State to imply that it means that the state has endorsed or approved the charity.



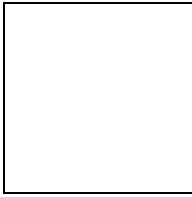
Solicitation calls may not be placed before 8:00 a.m. or after 9:00 p.m. No telephone solicitor may "harass, intimidate or torment" the person being solicited.



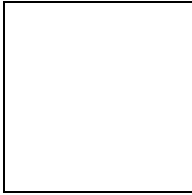
No solicitor may use the name, symbol or emblem of any other entity for the purpose of soliciting without the written consent of the other entity.



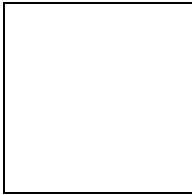
No solicitor may use a name, symbol, emblem or statement so similar to another's that its use would tend to confuse or mislead the public.



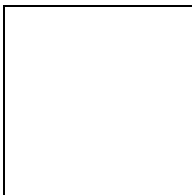
No one may solicit without first being registered, unless they are exempt from registration.



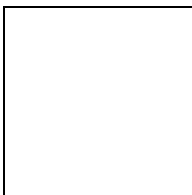
No one may state that tickets to a fundraising event will be donated to another person unless all of the following are true:



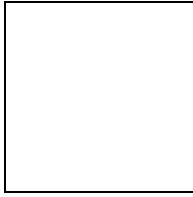
The commercial fundraiser prior to making the solicitation has written commitments from persons stating that they will accept donated tickets and specifying the number of tickets they will accept;



The commercial fundraiser keeps these written commitments on file for three years and makes them available to the Attorney General on demand;



The solicitor does not solicit sales of donated tickets in excess of the number for which it holds written commitments; and



At least 7 days prior to the event, all donated tickets are provided to the persons who made written commitments to accept them.

The rationale behind the last section is as follows. Many charitable solicitations are made by selling tickets to a fundraising event. Often, when the consumer declines to attend the event, the solicitor will reply that the consumer may still pay for tickets, and the tickets will then be donated--usually to disadvantaged children or some other worthy group. However, this practice is often abused. Often no tickets are actually donated and the fundraiser simply pockets the contributions that were to have paid for donated tickets. The rules set forth in the last section are designed to curb such abuses.

## **6. Record Keeping**

Both charitable organizations and commercial fundraisers must keep accurate books and records and maintain them at their main place of business until at least three years after the end of the year to which they relate. In addition, they must keep a record of all contributors who paid or donated more than \$25. The donor records and other books and records must be made available to the Attorney General upon request.

## **7. Violations**

It is a gross misdemeanor to knowingly violate the CSA or to knowingly file a false registration. It is a simple misdemeanor to commit any other violation of the CSA.

In addition to possible criminal prosecution, the Attorney General may file civil actions. Any violation of the CSA is a per se violation of the Consumer Protection Act. This means that when any person violates the CSA, the court may issue appropriate injunctions, impose civil penalties of up to \$2,000 per violation, order payment of restitution (money back) to consumers or charitable organizations who may have been damaged by the violations, and order the defendants to pay the costs and attorney's fees incurred by the Attorney General in prosecuting the action. The CSA is enforced by the Consumer Protection Division of the Attorney General's Office.

## **B. Washington Charitable Trust Act**

**Section B Authored by: [Jeffery Even](#), Assistant Attorney General for the State of Washington**

The Charitable Trust Act (“CTA”), codified in Chapter 11.110 RCW, applies to all entities, including corporations that meet the definition of a “trustee.” A nonprofit corporation meets this definition if it is either (1) formed for the administration of a charitable trust or (2) holds assets that can only be used for charitable, religious, eleemosynary, benevolent, educational or similar purposes.

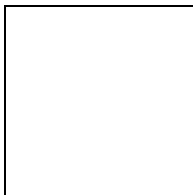
### **1. Significance of Charitable Trust Act**

#### **a. Attorney General Enforcement Powers**

The CTA empowers the attorney general to enforce the terms of the trust as the statutory representative of its public beneficiaries. Trustees are required to give the attorney general notice of all judicial proceedings affecting the trust or its administration in which the attorney general is a necessary party. The attorney general is authorized to investigate transactions and relationships involving the trust. This includes the authority to issue administrative orders requiring any person to appear to answer questions regarding trust administration.

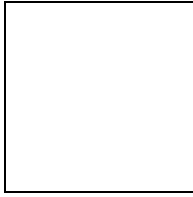
### **2. Registration Requirement**

Perhaps of greater day-to-day importance, some trustees are also required to register and report annually to the Secretary of State concerning the trustees’ affairs. While the law defines “trustee” for purposes of the attorney general enforcement powers very broadly, it requires only some trustees to register with the Secretary. The registration requirement applies when:



The trustee holds assets that are invested for income producing purposes. Even though assets are invested, all or part of the principle or income of the trust must be presently available for charitable purposes. A trustee is not required to register if the trust’s terms require that the assets be entirely expended for a charitable purpose within one year; and





The assets have a value of at least \$250,000.

### **3. How to Register and Report under the Charitable Trust Act**

To register, the trustee must file with the Secretary of State a copy of the instrument establishing the trust, an inventory of assets, and a registration form provided by the Secretary.

The annual reporting requirement is satisfied by filing with the Secretary a copy of the corporation's publicly available United States tax or information return, such as a Form 990 or 990 PF. A corporation that is not required to file either of these returns can instead file a separate form provided by the Secretary, describing the corporation's financial affairs.

## **C. Financial Records**

Section C authored by: [Rob Fleming](#) CPA, *Clark Nuber P.S.*

### **1. Importance of Maintaining Accurate and Timely Financial Records**

To be accountable to its constituency, as well as to maintain tax-exempt and corporate status with federal and State agencies, a nonprofit organization must maintain accurate and current financial records. Failure to maintain such records increases the likelihood of unauthorized removal of funds, may jeopardize a nonprofit organization's tax exempt status, and may leave directors and officers open to accusations regarding mishandling of funds. A nonprofit should utilize the services of an accountant with experience serving nonprofits to establish an accounting system and appropriate internal accounting controls.

### **2. How to Select and Use Financial Advisors**

Besides using an accountant to assist with developing a strong accounting system and internal controls, many nonprofit organizations also have their financial statements audited annually because the audit is required by its funding sources, such as banks, foundations, donors and government agencies. The selection of an accountant to assist with accounting systems and processing transactions is usually made by the executive director and controller. The selection of a certified public accountant to perform an annual audit is made by the board with input from the executive director.

There are three key criteria used in selecting financial advisors and auditors.

#### **a. Industry Knowledge**

There are a number of unique accounting and tax rules for nonprofits that are difficult to have a working familiarity with unless the financial advisor is exposed to nonprofits on a regular basis. The financial advisors in your community that have industry knowledge can be determined by calling other nonprofits and by contacting the Washington State Society of Certified Accountants.

#### **b. Size**

There is a tendency for financial advisory firms to serve entities that are of similar size. The larger accounting and financial consulting firms have the resources to meet the needs of larger organizations. Pick a firm that matches your size to receive the best service.

#### **c. Price**

The price of professional services should naturally be at the lowest amount that also meets the nonprofits other needs such as industry experience. To ensure competitive pricing, nonprofits commonly request proposals from at least three financial advisory firms. The proposals will allow

the nonprofit to assess the firms' overall capabilities, price of services and whether the firm provides a good match for the needs of the nonprofit.

### **3. Elements of a Good Accounting System**

A nonprofit organization should work with an accountant to develop a good accounting system. Whether a manual or computerized system is used, the basics are the same. All transactions should be recorded in a timely systematic manner to capture the cash activity and non-cash transactions. A systematic manner means a set of categories (chart of accounts) whereby similar transactions are grouped together. Every month the activity in each account is added up and summarized in the form of a financial statement. The financial statements should be compared to budgeted amounts and prior year amounts and fluctuations explained to management and the board.

### **4. Internal Controls for a Nonprofit Organization**

Because each nonprofit is unique, the appropriate internal controls may differ for each one and need to be separately assessed. However, many nonprofits have two characteristics that cause potential internal control issues. First, a nonprofit may receive cash contributions that can be stolen easily. To counter this, collections should be under the control of two or more people and deposits should be made timely. Second, many nonprofit cannot establish a segregation of duties because the nonprofit has a small administrative staff. To alleviate this weakness, the bookkeeper should not be a check signer; the person who does sign checks should review support for all disbursement; and someone other than the person in charge of the record keeping function should receive and review each month the unopened bank statement. Also, current period financial results should be compared to budgeted amounts and actual results from prior periods. Satisfactory explanations for significant fluctuations should be obtained.

### **5. Budgeting Essentials**

Budgeting is the process of putting the business plan for the next year into monetary terms. The best budgets are those that are well thought out and discussed in some detail with management and the board. Once prepared and approved, it is only a useful management tool if it is broken down into monthly periods that can be compared to actual results. Management and the board should review actual results compared to the budget and take action on significant fluctuations. In addition to the operating budget, a budget should be prepared for fixed asset additions.

### **6. Reporting Compensation and Other Expenses by Function**

Nonprofit organizations must report their expenses in financial statements on a functional basis. Many nonprofits used to report expenses on what was called a natural expense basis. This means reporting expenses by categories that are often used in a general ledger, such as salaries, and rent. This type of reporting did not provide the reader with any idea of how expenses are being spent on various programs of the organization or on overhead. Functional expense reporting requires that expenses be summarized by (1) program activities, (2) fundraising and management and (3) general.

The allocation of compensation and other expenses between program activities and management and general should be based, to the extent possible, on actual time records and other logs of actual time and usage. Some expenses are allocated based on other reasonable methods of allocation such as square footage.

## **7. Financial Accounting Standards Relating to Nonprofit Organizations**

For internal financial statements, a nonprofit organization may prepare financial statements in any format it wishes to provide useful information for its managers and directors. However, when preparing financial statements that will be distributed externally, a nonprofit must follow generally accepted accounting principles (“GAAP”). The Financial Accounting Standards Board (“FASB”) and the American Institute of Certified Public Accountants (“AICPA”) develop GAAP rules. There have been a number of important pronouncements issued recently by these organizations relating to nonprofit organizations with which nonprofits should be familiar. The most important of these pronouncements relate to accounting for contributions (FASB 116), financial statement formats (FASB 117), accounting for investments (FASB 124), accounting for fund raising costs (AICPA statement of Position 98-2), and guidance on accounting for the receipt of federal funds (AICPA statement of Position 98-3). An accountant familiar with nonprofits will be acquainted with these pronouncements.

## **8. Employment Taxes and Benefits**

### **a. Federal Withholding and Social Security Taxes**

Nonprofit organizations are required to withhold and pay federal income taxes and social security taxes on wages in the same manner as for-profit organizations. An accountant should be consulted regarding setting up, withholding and paying these taxes.

### **b. Unemployment Taxes**

An organization formed under IRS Section 501(c)(3) is not required to pay federal unemployment taxes, but must participate in Washington’s unemployment program or an approved alternate trust agency. All other exempt organizations are required to pay federal unemployment taxes.

### **c. Worker’s Compensation**

All employers of one or more persons must register with the Department of Labor and Industries and establish an Industrial Insurance Account. The filing of the Master Business Application takes care of the registration. Employers must pay to the Department of Labor and Industries each quarter from the employer and employee’s salary.

## **9. Other (Benefit Programs)**

A nonprofit organization may wish to investigate health insurance and other benefits in order to provide employees with such benefits. Accurate records must be established to keep track of any benefits offered. An organization should also consider establishing personnel policies that set forth hiring, firing, temporary leave, vacation and other employment policies.

## D. Washington State Taxes and Nonprofit Corporations

Section D authored by: [Mark Hugh](#) CPA, *Clark Nuber P.S.*

### 1. Generally

In Washington, nonprofit organizations are presumed taxable in the same manner as for-profit organizations. Therefore, if no statutory exemption or deduction exists, a nonprofit organization must pay, to the extent applicable, each of the following taxes: (i) State and local business and occupation taxes, (ii) State and local sales taxes, (iii) State and local use taxes and (iv) real and personal property taxes.

The general presumption in favor of taxation means that while a nonprofit organization should assume all its business activities are taxable, it should also determine whether a specific exemption or deduction applies to the specific activity or transaction. Exemption from taxation will depend on the characterization of the revenue (i.e., retailing, services, wholesaling or manufacturing) or the transaction (sales or use taxes). A nonprofit organization claiming a benefit or deduction from a taxable category has the burden of establishing that it qualifies for the benefit or deduction.

### 2. State Business and Occupational Taxation

#### a. Defined

Washington imposes a business and occupation tax (“the B&O tax”) based on the gross receipts of every person engaged in business activities in the State. Thus, a nonprofit organization engaged in business activities must pay the B&O tax based the value of its products, the gross proceeds of its sales, or the gross income of its business, as appropriate. Typically, a nonprofit organization pays tax under at least two general classifications under the B&O tax. These classifications are (i) retailing and (ii) the “catch-all” classification known as Service and Other Activities.

#### i. Retailing

Retailing includes every sale of tangible personal property to consumers (e.g., sales of publications, periodicals, books and tapes). Retailing also includes certain services such as repair of property and certain personal services such as health and fitness activities. Nonprofit organizations must pay a tax, currently at a rate of four hundred seventy-one one thousandths percent (.471%) of the organization’s gross sales proceeds from such items. Items in this category are also subject to the retail sales tax.

#### ii. [Service and Other Activities.](#) (The “Catch-All” Category)

The Service and Other Activities category includes all other sources of income that do not fall into another B&O tax category. Nonprofit organizations must pay a tax, currently at a rate of one and one-half percent (1.5%) of the gross income the organization receives from such taxable items as

services, gains, interest, rents, fees, advertising income, dues, reimbursements, agency fees and commissions. Unlike retailing, items in this category are not subject to the retail sales tax.

**b. Exemptions for Certain Service Businesses and the Small Business Tax Credit**

**i. Certain Service Businesses**

Nonprofit organizations engaged in performing services that are not included in the definition of retailing are not required to pay the B&O tax if their gross annual receipts are twelve thousand dollars (\$12,000) or less and the organization is not required to pay over any other tax such as the sales or use tax.

**ii. The Small Business Tax Credit**

The Small Business Tax Credit may offset all or a portion of the B&O tax. For example, a nonprofit organization that reports in the Service and Other Activities classification will pay no B&O tax if its gross receipts are twenty-eight thousand dollars (\$28,000) or less on an annual basis. This credit, however, applies only to the B&O tax due from the organization and does not apply to any retail sales and use taxes due.

**c. Exemptions and Deductions for Specific Organizations**

Washington exempts certain nonprofit organizations from liability for the B&O tax. These organizations include “artistic and cultural organizations;” blood, bone and tissue bank; adult family homes and the Red Cross.

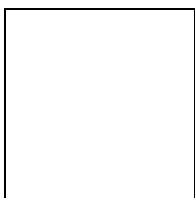
**i. Artistic and Cultural Organizations**

**A. Permitted Deduction**

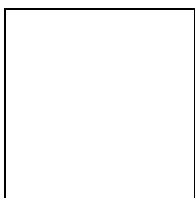
Artistic and cultural organizations may deduct from their B&O tax liability all their income from business activities.

**B. Defined**

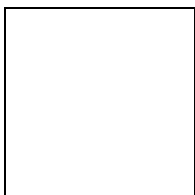
Artistic or cultural organizations include nonprofit corporations that are organized and operated exclusively for the purpose of providing “artistic or cultural exhibitions, presentations or performances or cultural or art education” for viewing or attendance by the general public. The term “artistic or cultural exhibitions, presentations, or performances or cultural or art education programs” includes and is limited to:



An exhibition or presentation of works of art or objects of cultural or historical significance, such as those commonly displayed in art or history museums;



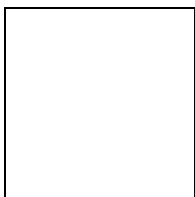
A musical or dramatic performance or series of performances; or



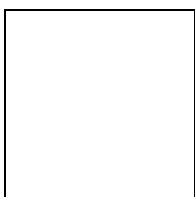
An educational seminar or program, or series of such programs, offered by the organization to the general public on an artistic, cultural, or historical subject.

### C. Qualification

To qualify for the permitted deduction, a nonprofit corporation must meet the following requirements:

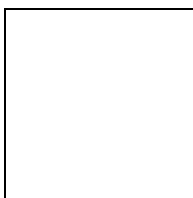


The organization must be either (i) a nonprofit corporation organized and managed by a governing board of not less than eight (8) individuals none of whom is a paid employee of the corporation or (ii) a corporation sole.



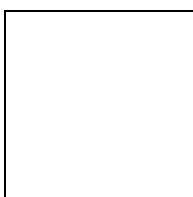
No part of the corporation's income may be paid directly or indirectly to its members, stockholders, officers, directors or trustees, except in the form of services rendered by the corporation in accordance with its purposes and bylaws;



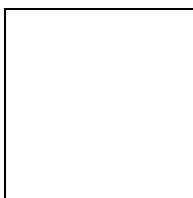


Salary or compensation paid to the corporation's officers and executives must be only for actual services rendered, and at levels comparable to the salary or compensation of like positions within the State;

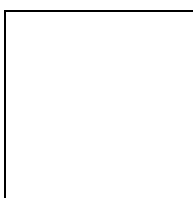
Assets of the corporation must be irrevocably dedicated to the activities for which the exemption is granted and, upon liquidation, dissolution, or abandonment by the corporation, may not inure directly or indirectly to the benefit of any member or individual, except a nonprofit organization, association, or corporation which would also be entitled to the exemption;



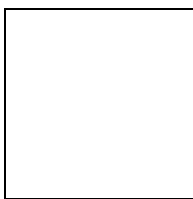
The corporation must be duly licensed or certified when licensing or certification is required by law or regulation;



The amounts received that qualify for exemption must be used for the activities for which the exemption is granted;



Services must be available regardless of race, color, national origin or ancestry; and



The Department of Revenue must have access to the corporation's books to determine whether the corporation should be exempt.

#### **D. Related Sales and Use Tax Deduction**

Artistic and cultural organizations are also exempt from paying the retail sales or use tax on certain objects used for the purposes of exhibition or presentation to the general public. These objects include objects of art, cultural value and objects to be used in displaying art or presenting artistic or cultural exhibitions or performances.

**ii. Blood, Bone and Tissue Bank**

Blood, bone and tissue banks are completely exempt from the B&O tax to the extent amounts received is exempt from federal income tax.

**iii. Adult Family Homes**

Adult family homes are exempt from the B&O tax.

**iv. The Red Cross**

State laws exempt this organization from the B&O tax.

**d. Exemptions and Deductions for Specific Events**

**i. Fund Raising Activities**

**A. Permitted Exemption**

Washington exempts a qualifying “nonprofit organization’s” “fund raising activities” from the B&O tax and the retail sales tax.

**B. “Fund Raising Activity” Defined**

Fund raising activity means activities involving both the direct solicitation of money or other property and the anticipated exchange of goods or services for money between the soliciting organization and the organization or person solicited, for the purpose of furthering the goals of the nonprofit organization.

Fund raising activity does not include the operation of a regular place of business in which sales are made during regular hours such as a bookstore, thrift shop, restaurant or similar business.

**C. “Nonprofit Organization” Defined**

Nonprofit organization means one of the following:

An organization exempt from tax under Section 501(c)(3), (4), or (10) of the Internal Revenue Code;

A nonprofit organization that would qualify for the exemption except that it is not organized as a nonprofit corporation; or

A nonprofit organization that meets all of the following criteria:

The members, stockholders, officers, directors or trustees of the organization do not receive any part of the organization's gross income, except as payment for services rendered;

The compensation received by any person for services rendered to the organization does not exceed an amount reasonable under the circumstances; and

The activities of the organization do not include a substantial amount of political activity, including, but not limited to, influencing legislation and participation in any campaign on behalf of any candidate for political office.

#### D. Additional Permitted Exemption Nonprofit

Organizations that purchase items to be resold as part of a qualifying fund raising activity may purchase the items to be resold without payment of the sales tax and may provide their vendors with a valid resale certificate.

#### E. Other State Tax Consequences of Fund Raising Activities

Nonprofit organizations must still pay the retail sales tax on consumable items incorporated into fund raising activities. For example, if as part of an auction, an organization distributes free programs to attendees containing descriptions of the property to be auctioned, the program is considered a consumable item and the organization must pay sales or use tax to the printer or publisher.

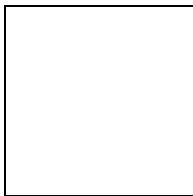
Buyers of tangible personal property will still owe the use tax on all purchases of applicable items at any fundraiser. Thus, while a nonprofit organization has no sales tax collection responsibilities for such items, the buyer must still pay use tax on the items purchased.

Nonprofit organizations exempt from real or personal property taxes are allowed to use their exempt property for fund raising purposes for limited time periods without terminating their property tax exemptions. The use of exempt property for fund raising activities sponsored by an exempt organization does not subject the property to taxation if the fund raising activities are consistent with the purposes for which the exemption was granted. For property tax exemption purposes, the term "fund raising" means any revenue-raising activity limited to less than five (5) days in length that disburses fifty-one percent (51%) or more of the profits realized from the activity to the exempt nonprofit organization, association, or corporation conducting the fund raising activity.

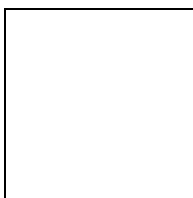
Nonprofit organizations are still responsible for local B&O taxes, if any, on the fund raising activities.

#### ii. Trade Shows, Conventions and Seminars

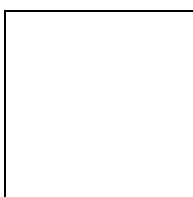
Nonprofit organizations may exempt attendance and space charges incurred in connection with trade shows, conventions and seminars from the B&O tax if the following conditions are satisfied:



The sponsoring organization must be exempt under Section 501 of the Internal Revenue Code;



The sponsoring organization must either be a “trade organization” or a “professional organization.” A “professional organization” is an entity whose members are engaged in a particular lawful vocation, occupation or field of activity of a specialized nature. A “trade organization” is an entity whose members are engaged "in trade" (i.e., in one or more lawful commercial trades, businesses, crafts, industries or distinct productive enterprises); and

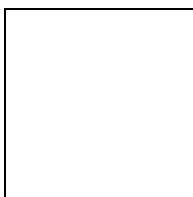


The event must not be open to the general public. This means that: (1) attendance is limited to members of the sponsoring organization and to specific invited guests of the sponsoring organization; or (2) if attendance is not limited to members and specifically invited guests, all proceeds from the trade show, convention or seminar are subject to B&O tax.

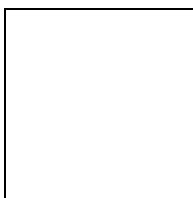
#### **e. Exemptions and Deductions for Specific Revenue Streams**

##### **i. Rents**

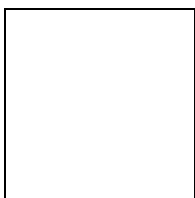
Rents received from long-term leases of real property for periods of thirty (30) days or more are exempt from the B&O tax. Otherwise, rental income is likely subject to the B&O tax. For instance:



Short-term rentals by those who hold themselves out to the public as hotels and motels are subject to the retailing B&O tax.



Short-term rentals of other types of real property are subject to the Service and Other Activities B&O tax.



Rentals of personal property are subject to the retailing B&O tax.

#### ii. Advancements and Reimbursements

Advancements and reimbursements made by nonprofit organizations are deductible the organization receiving the reimbursement had no liability other than as agent when the original payment was made. Nonprofit organizations should be aware, however, that this possible deduction poses a significant audit trap, especially for affiliates of the organization.

If an employee works exclusively for one organization, but is paid by another, no tax is due on the reimbursement by the employer to the paymaster. This exemption does not apply to shared employees such as corporate officers.

#### iii. Income Exempt Under the U.S. Constitution

The federal constitution prohibits Washington from taxing revenue derived from interstate sales, imports and exports, Indians and Indian tribes, or sales made by the federal government. Nonprofit organizations that sell to the federal government are generally subject to the B&O tax.

#### iv. Investment Income

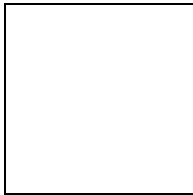
Investment income includes gross proceeds of sales, compensation for the rendition of services, gains realized from trading in stocks, bonds, or other evidences of indebtedness, interest, discount, rents, fees, commissions, dividends and other emoluments however designated, all without any deduction on account of the cost of tangible property sold, the cost of materials used, labor costs, interest, discount, delivery costs, taxes or any other expense whatsoever paid or accrued and without any deduction on account of losses.

This deduction is available only to nonprofit organizations not engaged in banking, loan, security or other financial business. If the nonprofit organization's investment income for the year is five percent (5%) or less of all gross receipts, the organization will be presumed to not be in a financial business and the deduction will apply. For the purpose of this calculation, both the numerator and denominator include all revenues, including those otherwise deductible or exempt.

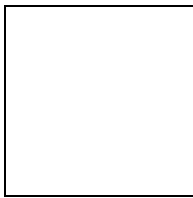
If the nonprofit organization's investment income is greater than five percent (5%), the Department of Revenue will subjectively consider other factors to determine if the organization's activities arise to the level of a financial business. In making its determination, the Department of Revenue considers such factors as the source of the income, frequency of investments, volume of investments, percentage of investment income to total income and the relationship of the investment income to other activities of the organization. Such activity must be regular and recurrent.

v. Sheltered Workshops

Sheltered workshops operated by nonprofit organizations are exempt from tax on any kind of business activities either on or off the premises. The operation of sheltered workshops means performance of business activities of any kind, on or off the premises of a nonprofit organization, which are performed for the primary purpose of:



Providing gainful employment or rehabilitation services to the handicapped as an interim step in the rehabilitation process for the handicapped who cannot be readily absorbed in the competitive labor market or during such time as employment opportunities for the handicapped in the competitive labor market do not exist; or



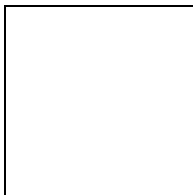
Providing evaluation and work adjustment services for handicapped individuals.

vi. Bona Fide Dues

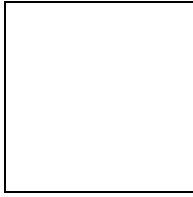
A nonprofit organization may exempt the bona-fide dues of its members. Bona-fide dues are defined as those amounts paid periodically by members solely for the purpose of entitling those persons to continued membership in the club or similar organization.

A nonprofit organization may not be eligible for this exemption, however, if, in consideration of the dues, the members receive significant goods or services or if dues are graduated based on the level of services provided.

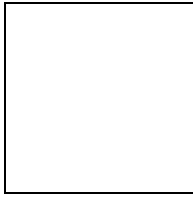
The Department of Revenue has ruled that a nonprofit organization may provide the following significant goods and services, without causing the deduction for dues to be lost:



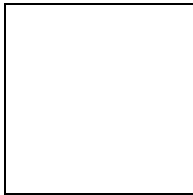
The provision of newsletters of a general informational nature to members;



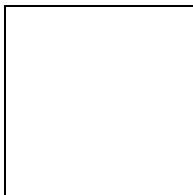
The conduct of regulatory and legislative liaison or lobbying activities of a non-specific nature on the behalf of members;



The conduct of conventions and shows for members;



The conduct of meetings and seminars of general and varied interest to members; and



Member discounts, if those discounts are separately charged for the goods and services and the charges were for at least the full cost of the goods and services.

Although bona-fide dues may be exempt from the B&O tax, the dues may be subject to other taxes. For example, physical fitness services of a non-instructional nature are subject to the sales tax. Therefore, if a nonprofit organization provides these services in exchange for dues, an organization must allocate dues between taxable and nontaxable amounts.

A deduction is allowed for all membership fees and fees for camping and recreational services if received by a nonprofit youth organization.

Golf businesses are allowed to use market comparisons to allocate dues to retailing.

#### vii. Bona Fide Contributions and Donations

Gifts, contributions and donations received by a nonprofit organization are not subject to the B&O tax. If the income received is part sale and part gift, the measure of the B&O tax is the lesser of the selling price or the fair market value of the item sold. The excess of the selling price over the fair



market value is a nontaxable donation. The Department of Revenue will accept an organization's reasonable allocation of the fair market value and donation portions of the sales proceeds.

#### viii. Initiation Fees

Initiation fees are exempt from B&O tax liability. "Initiation fees" means those amounts paid solely to initially admit a person as a member to a club or organization. These fees are only those one-time amounts paid which genuinely represent the value of membership in a club or similar organization. An initiation fee does not include any amount paid for or attributable to the privilege of receiving any goods or services other than mere nominal membership.

#### ix. Tuition fees

"Tuition fees" includes library, laboratory, health service and other special fees, and amounts charged for room and board by an educational institution when the property or service for which such charges are made is furnished exclusively to the students or faculty of such institution. "Educational institution" means only those institutions created or generally accredited as such by the state. An "educational institution" offers to its students an educational program of a general academic nature.

#### x. Kindergartens

Charges for the operation of privately operated kindergartens are exempt from B&O tax liability. The Department of Revenue interprets this deduction to include income received by nursery schools, preschools, day care providers and privately operated kindergartens for the care or education of children who are under eight years of age and not enrolled in or above the first grade. Effective July 1, 1998, a special B&O tax rate of .471% was established for those who provide day care services or care of children eight years or older or at the first grade level or above.

#### xi. Endowment Funds

Income from endowment funds is exempt from B&O tax liability.

#### xii. Grants

Grants received by nonprofit organizations may be deductible from the B&O tax under the bona-fide contribution and donation exemption. However, if the grants received are in exchange for significant goods or services, the bona-fide contribution and donation deduction does not apply. To qualify a grant for this exemption, the grantee may have to establish the grantor has a "gratuitous intent" in making the grant.

A grant is presumed nontaxable if three conditions are met: (1) The grantor must receive no significant goods, services or benefits in return for making the grant; (2) The grantee is a nonprofit or governmental organization; and (3) The grant must be used to promote, advance or fulfill

charitable purposes, including related administrative expenses, within the meaning of Section 501(c)(3) of the Code.

A safe harbor provision exists for certain restrictions imposed by the grantor regarding grantee accountability. This provision permits a grantor to place restrictions on the use of the grant for specific charitable purposes and provides that a grantee may submit accountability reports to the grantor regarding the use of the funds or describing the general nature of the project.

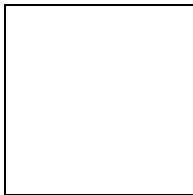
Sponsorship or public acknowledgement that the grantor provides a grant, alone does not trigger B&O tax liability for the grantee.

Several statutory provisions permit nonprofit research institutions to reduce their potential tax liability. A special B&O tax classification exists for nonprofit organizations that engage in research and development within Washington. The rate is .484%.

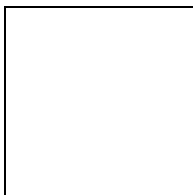
Taxable grants, if performed within and without the state, may be apportionable service income.

Grants by the federal government to municipal corporations or political subdivisions of the State may be deducted from B&O tax liability.

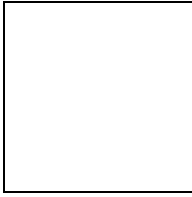
“Health or social welfare organizations” are allowed to deduct grants or fees received from government sources for providing certain “qualifying services.” First, the organization must qualify as a “health or social welfare organization,” which requires that the organization meet the following requirements:



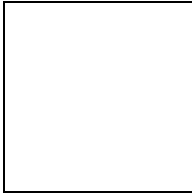
The organization must be either (A) a nonprofit corporation and must be managed by a governing board of not less than eight (8) individuals none of whom is a paid employee of the organization or (B) a corporation sole;



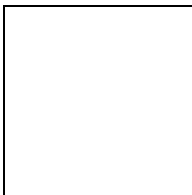
No part of the corporation’s income may be paid directly or indirectly to its members, stockholders, officers, directors or trustees, except in the form of services rendered by the corporation in accordance with its purposes and bylaws;



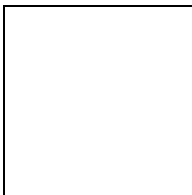
Salary or compensation paid to the corporation's officers and executives must be only for actual services rendered, and at levels comparable to the salary or compensation of like positions within the public service of the state;



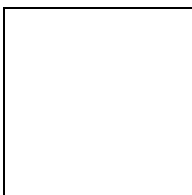
Assets of the corporation must be irrevocably dedicated to the activities for which the exemption is granted and, upon liquidation, dissolution or abandonment by the corporation, may not inure directly or indirectly to the benefit of any member or individual, except a nonprofit organization, association or corporation which would also be entitled to the exemption;



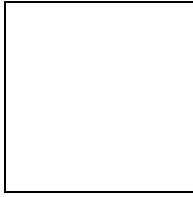
The corporation must be duly licensed or certified where licensing or certification is required by law or regulation;



The amounts received qualifying for exemption must be used for the activities for which the exemption is granted;



Services must be available regardless of race, color, national origin or ancestry; and



The Department of Revenue must have access to the corporation's books in order to determine whether the corporation should be exempt.

Second, *qualifying services* are limited to mental health, drug or alcoholism counseling; family counseling; health care services; therapeutic, diagnostic, rehabilitative or restorative services for the care of the sick, aged or certain disabled individuals; activities for the prevention of juvenile delinquency or child abuse; care of orphans or foster children; day care of children; employment development, training, and placement; indigent legal services; low-income weatherization or home repairs; low-income heating assistance; or community services to low-income families and groups designed to reduce poverty in a measurable way.

Third, this deduction applies only to amounts the corporation received from the United States or any instrumentality thereof or from the State of Washington or any municipal corporation or political subdivision thereof as compensation for, or to support, health or social welfare services.

Several issues frequently arise surrounding the health or social welfare deduction. If a fee or grant is received from a non-governmental organization, such as a for-profit organization, charitable foundation or another nonprofit organization, this deduction does not apply and the nonprofit corporation must analyze its B&O tax liability under the general rule that permits taxation of grants if those grants are exchanged for services. Any compensation for services from a non-governmental payer would be taxable.

The same analysis applies if a qualifying nonprofit corporation receives a government grant to provide services other than services meeting the definition of "*qualified services*" described above.

No member of the board of directors of the nonprofit corporation may be a paid employee. The Department of Revenue has asserted in audits of nonprofit corporations that if the executive director, a paid employee, is directly involved in the decision making or management by the board of directors, no deduction is applicable. Therefore, the nonprofit organization's government grants for otherwise qualifying services becomes taxable. However, if the executive director serves on the board in an advisory capacity, without voting rights, the Department of Revenue has allowed a deduction. Cautious nonprofit organizations that qualify for this deduction may want to ensure that the organization's by-laws provide that the executive director can only act in an advisory capacity to the board of directors, without voting rights, or remove the executive director from the board of directors entirely.

Salary or compensation paid to officers and executives must be at levels comparable to the salary or compensation of like positions within the public service of the State. The Department of Revenue has attempted to disqualify an organization from this deduction by showing the organization's executives were not paid salaries comparable to salaries paid at like positions in the public service.

### 3. Local Business and Occupation Taxation

#### a. Generally

State law permits cities to impose a local business and occupation tax. Over thirty-five (35) Washington cities assess such a tax, including Seattle, Tacoma, Bellevue, Bellingham, Everett and Olympia. Each city administers its business and occupation tax independently.

#### b. Comparison to State Tax

Most cities imposing a local business and occupation tax follow the state level definitions of activities such as manufacturing, wholesaling, retailing and services. However, cities offer far fewer exemptions and deductions to their local business and occupation tax than the State does. Moreover, unlike the state level tax, local business and occupation taxes are true “gross receipts” taxes and are essentially taxes on the “privilege” of doing business within the city rather than taxes on the actual business activity conducted within the city. Consequently, cities often impose a business and occupation tax on activities with only minimal connection to business activities conducted within the taxing city.

#### c. Local Exemptions

Most cities provide credits or exemptions for (i) amounts upon which a gross receipt tax was paid to another Washington city or (ii) multiple activity credits for “intra-city” activities. In contrast, “inter-city” activities are usually subject to double taxation. “Intra-city” activities are those occurring within one city, whereas “inter-city” activities are those occurring in two or more cities.

#### d. Local Rates

The following table lists the business and occupation tax rates for a few Washington cities:

City	Service rate	Retailing rate
Bellevue	.1496%	.1496%
Seattle	.4150%	.2150%
Tacoma	.4400%	.1530%

#### e. Minimum Thresholds Required for Taxation in Selected Cities

##### i. Bellevue

The City of Bellevue exempts nonprofit organizations whose annual gross receipts total less than \$100,000 from its local business and occupation tax. The City of Bellevue also exempts from its business and occupation tax nonprofit organizations that are exempt under Sections 501(c)(3), (4), and (7) of the Internal Revenue Code.

ii. Seattle

The City of Seattle exempts nonprofit organizations whose annual gross receipts total less than \$50,000 from its business and occupation tax.

iii. Tacoma

Like Seattle, the City of Tacoma exempts nonprofit organizations whose annual gross receipts total less than \$65,000 from its business and occupation tax. The City of Tacoma is gradually raising its minimum threshold over a number of years. Thresholds for future years are \$70,000 for the year 2002 and forward.

**f. Trade Shows, Conventions and Seminars**

i. Bellevue

The City of Bellevue fully taxes attendance and space charges for trade shows, conventions, and seminars if sponsored by an organization other than those exempt under Sections 501(c)(3), (4), and (7) of the Internal Revenue Code.

ii. Seattle

The City of Seattle fully taxes attendance and space charges for trade shows, conventions and seminars.

iii. Tacoma

The City of Tacoma fully taxes attendance and space charges for trade shows, conventions and seminars if not sponsored by an organization exempt under Section 501(c)(3) of the Internal Revenue Code.

**g. Grants**

i. Bellevue

The City of Bellevue allows nonprofit organizations a deduction for bona fide contributions and donations, as long as the contributions and donations are not received in exchange for significant goods or services.

The City of Bellevue also exempts all income received by organizations exempt under Sections 501(c)(3), (4), and (7) of the Internal Revenue Code.

ii. Seattle

Like Bellevue, the City of Seattle allows nonprofit organizations a deduction for bona fide contributions and donations, as long as the contributions and donations are not received in exchange for significant goods or services.

The City of Seattle, however, does not permit a deduction for “grants” received in return for the preparation of “studies, white papers or reports,” because such “grants” are deemed to be in exchange for services.

### iii. Tacoma

The City of Tacoma also allows nonprofit organizations a deduction for bona fide contributions and donations, as long as the contributions and donations are not received in exchange for significant goods or services. Additionally, the City of Tacoma exempts all amounts nonprofit organizations derive from program service fees, government grants and/or contract receipts, and private foundation grants by any organization organized and operated for charitable, educational, or other purposes which is exempt from taxation pursuant to Section 501(c)(3) of the Internal Revenue Code.

## h. Health or Social Welfare Organizations

### i. Bellevue

The City of Bellevue exempts all income received by organizations exempt under Sections 501(c)(3), (4), and (7) of the Internal Revenue Code. This exemption is broader than that permitted by the State.

### ii. Seattle

The City of Seattle permits nonprofit organizations the same exemption as that allowed by the State.

### iii. Tacoma

The City of Tacoma allows a deduction for all amounts derived from program service fees, government grants and/or contract receipts, and private foundation grants by any organization organized and operated for charitable, educational, or other purposes which is exempt from taxation pursuant to Section 501(c)(3) of the Internal Revenue Code. Like the deduction provided by the City of Bellevue, this deduction is broader than that allowed by the State.

## i. Artistic and Cultural Organizations

### i. Bellevue

The City of Bellevue exempts all income received by organizations exempt under Sections 501(c)(3), (4), and (7) of the Internal Revenue Code. This exemption is broader than that permitted by the State.

ii. **Seattle**

The City of Seattle taxes nonprofit organizations of this type on their income derived from retailing activity and their income derived from parking.

iii. **Tacoma**

The City of Tacoma allows a deduction for all amounts derived from program service fees, government grants and/or contract receipts and private foundation grants by any organization organized and operated for charitable, educational or other purposes which is exempt from taxation pursuant to Section 501(c)(3) of the Internal Revenue Code. However, the City of Tacoma does tax the retailing or wholesaling activity of the organization.

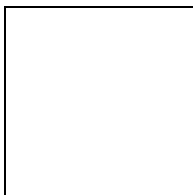
**4. Sales Tax Issues for Nonprofit Organizations**

**a. Generally**

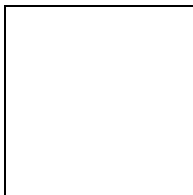
Washington imposes a tax upon the sale of any article of tangible personal property to consumers. Therefore, unless an exemption applies, nonprofit organizations should collect the sales tax on all sales of tangible personal property.

**b. Exemptions**

The following sales of tangible personal property by a nonprofit organization are exempt from the sales taxes:

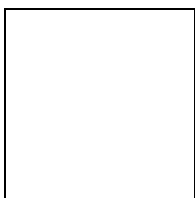


Sales to the Red Cross;

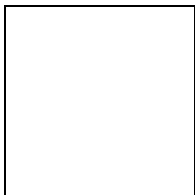


Sales of food products for human consumption. The exemption applies only to certain food products that are not sold for immediate consumption on the premises;

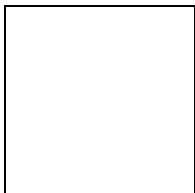




Sales to artistic or cultural organizations of certain objects acquired for exhibition or presentation. This includes objects of art and objects to be used in presenting cultural exhibitions or performances;



Sales of amusement or recreational services and physical fitness services provided by nonprofit youth organizations; and



Certain fundraising activities.

#### **c. Collection**

The seller of the tangible personal property item acts as the collection agent for the state in collecting the sales tax. A seller commits a misdemeanor if it fails to pay collected sales taxes to the state by the due date. If a seller fails to collect the required sales tax on a taxable transaction, the tax remains a debt owed by the buyer to the seller. However, it is the seller who becomes personally liable for the uncollected tax to the state.

#### **d. Rates**

The state base rate is six and one-half percent (6.5%). Local sales tax may be no more than one and seven-tenths percent (1.7%). Thus, the combined state and local rate for most counties is eight and two-tenths percent (8.2%). However, in most parts of King, Pierce and Snohomish counties, the regional transit authority imposes an additional four-tenths of a percent (.4%) tax on transactions. Therefore, the combined rate in Pierce and Snohomish counties is eight and six-tenths percent (8.6%). King County imposes an additional one-half of one percent (.5%) tax on the consumption of food in restaurants, taverns and bars, giving it a combined rate of nine and one-tenth percent (9.1%).

## 5. Use Tax Issues for Nonprofit Organizations

### a. Generally

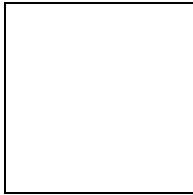
Washington imposes a tax on the user of any article of tangible personal property acquired by purchase or gift where the user or donor has not paid the retail sales tax.

### b. Rates

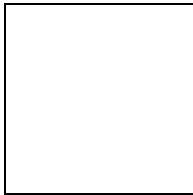
The use tax rates are the same as the combined state and local portions of the sales tax.

### c. Contingent Liabilities

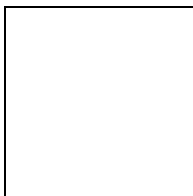
Most nonprofit organizations, like most other consumers and businesses, have contingent use tax liabilities for small items purchased such as:



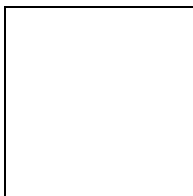
Computer equipment, licenses and software purchased from out-of-state sources;



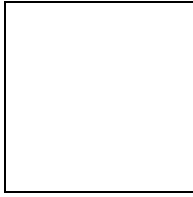
Any mail order catalog items;



Fixed assets shipped into Washington from a seller outside of Washington who does not collect the sales tax;



Magazine and periodical subscriptions; and



Office supplies, if purchased from out-of-state sources.

#### **d. Donated Items**

For many years, nonprofit organizations had a substantial use tax liability for donated items used by the organization if the organization could not prove the donor had paid sales tax. Now, however, the use tax does not apply to donations of tangible personal property used by a “nonprofit charitable organization.” “Nonprofit charitable organizations” are those generally exempt under Section 501(c)(3) of the Internal Revenue Code. Other nonprofit organizations will continue to have a use tax obligation unless the organization can substantiate that the donor paid sales or use tax on the donated item. The donated item exception does not apply to purchases of property by nonprofit organizations. In 1998, the State Legislature expanded the exemption to exempt the donors of tangible personal property from the use tax and also exempted the donation of tangible personal property incorporated into the real or personal property for no charge.

### **6. Real Estate Excise Tax Issues**

#### **a. The Tax**

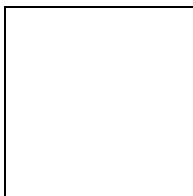
Washington imposes a transfer tax on the sale of real property including leasehold improvements and those involving a fifty-percent (50%) or more controlling interest in any entity that owns the real property.

#### **b. Liability**

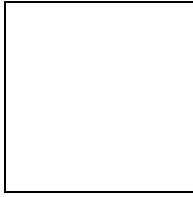
Nonprofit organizations, even if exempt from real or personal property taxes, are nevertheless subject to the real estate excise tax unless the transaction is otherwise specifically exempt.

#### **c. Exemptions**

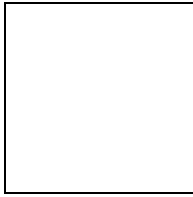
There are numerous exceptions to the real estate excise tax, including:



Gifts of real property;



Transfers of real property that consist of a mere change in the identity or form of ownership; and

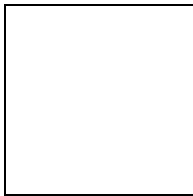


Transfers of real property that for federal income tax purposes do not involve the recognition of gain or loss for the purposes of entity formation, dissolution or reorganization.

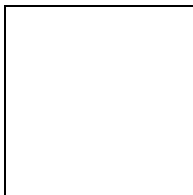
## 7. **Property Tax Issues**

### a. **Generally**

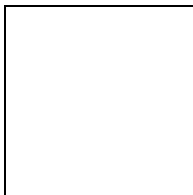
Washington exempts qualifying nonprofit organizations from the payment of:



Real property taxes;



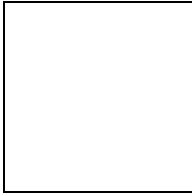
Personal property taxes; and



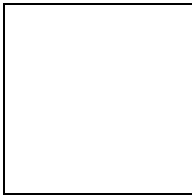
Leasehold excise taxes. This is a twelve and eighty-four one hundredths percent (12.84%) tax on leasehold interests in publicly owned real or personal property. The tax base is measured by the amount paid for the use of the property. If a nonprofit organization receives the use of donated property, the tax base is the fair market value of the rents on similar property.

**b. Limited Scope**

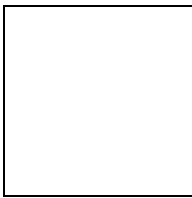
Not all nonprofit organizations qualify for exemption from payment of property taxes. Exemptions are only allowed for specific types of activities. Qualifying activities include:



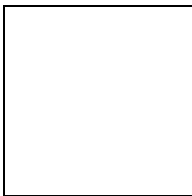
Public property.



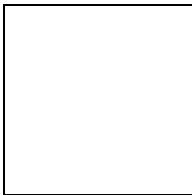
Cemeteries, churches, parsonages, convents, and grounds.



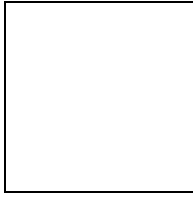
Property used for character building, benevolent, protective or rehabilitative social services, camp facilities, veteran or relief organization-owned property, property of nonprofit organizations that issue debt for student loans or that are guarantee agencies.



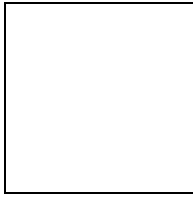
Administrative offices of nonprofit religious organizations.



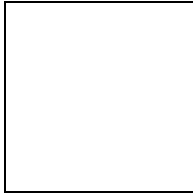
Nonprofit organizations engaged in procuring, processing, etc., blood, plasma or blood products.



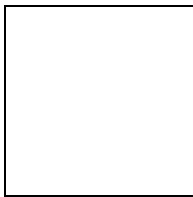
Nonprofit organizations, property connected with operation of public assembly halls or meeting places.



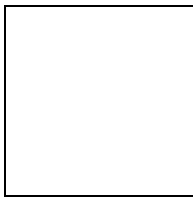
Nonprofit day care centers, libraries, orphanages, homes or hospitals for the sick or infirm, outpatient dialysis facilities.



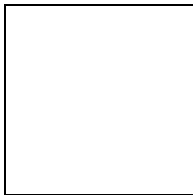
Nonprofit homes for the aging.



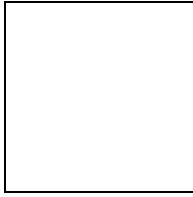
Nonprofit organizations, property used in providing emergency or transitional housing to low-income homeless persons or victims of domestic violence.



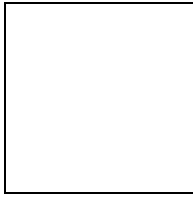
Nonprofit organizations, property available without charge for medical research or training of medical personnel.



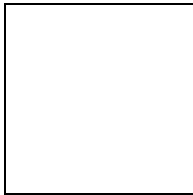
Nonprofit cancer clinics or centers.



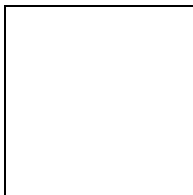
Nonprofit organizations, property used for transmission or reception of radio or television signals originally broadcast by governmental agencies.



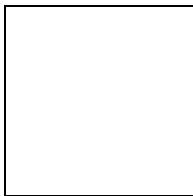
Schools and colleges.



Art, scientific and historical collections and property used to maintain such collections, property of associations engaged in production and performance of musical, dance, artistic, etc., works, property to be used for exempt purpose in future, fire engines, implements, and buildings of cities, towns, or fire companies, humane societies.



Water distribution property owned by nonprofit corporations or cooperative associations.



Property owned or used for sheltered workshops for handicapped.

### **c. Application for Exemption**

A nonprofit organization must apply in advance of receiving an exemption for property taxes and renew its exemption with the Department of Revenue by March 31st of each year.

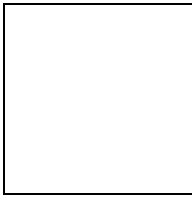
**d. Use of Exempt Property**

**i. Exclusivity Requirement**

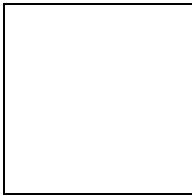
Once exempt, the property must be exclusively used for its exempt purpose.

**ii. Loan or Rental of Exempt Property**

As a general rule, the loan or rental of all or a portion of the exempt property does not subject the property to taxation if:



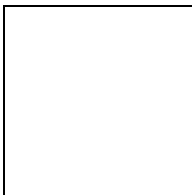
The rents or donations received for the use of the property are reasonable and do not exceed the maintenance and operation expenses attributable to the portion of the property loaned or rented; and



The property would be exempt from tax if owned by the organization to which it is loaned or rented, except for property owned by organizations and societies of war veterans, public assembly halls, public meeting places, community meeting halls and community celebration facilities.

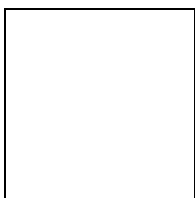
**A. Property Loaned or Rented for less than Fifteen (15) Days**

If exempt property is loaned or rented, the tax-exempt status of the property will not be affected if:

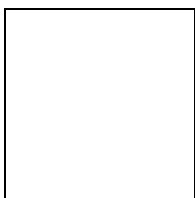


The property is loaned or rented for a period of fifteen (15) consecutive days or less;





The property is loaned or rented to another nonprofit organization, association, or corporation that would qualify for exemption if it owned the loaned or rented property, unless the property is owned by organizations and societies of war veterans, public assembly halls, public meeting places, community meeting halls and community celebration facilities; and



All income received from the rental is devoted exclusively to the exempt purpose of the nonprofit organization that receives the tax exemption.

#### **B. Property Loaned or Rented to Produce Income**

If the property is loaned or rented and the lessor or lessee intends to produce revenue from the loan or rental, the property loses its exemption. Property loaned or rented from which revenue is to be produced must be segregated and taxed whether or not the revenue is devoted to exempt purposes.

#### **iii. Fund Raising Activities**

The use of exempt property for “fund raising” activities sponsored by an exempt nonprofit organization does not subject the property to taxation if the fund-raising activities are consistent with the purposes for which the exemption was granted. "Fund raising" means any revenue-raising activity limited to less than five (5) days in length that disburses fifty-one percent (51%) or more of the profits realized from the activity to the exempt nonprofit organization conducting the fund raising.

### **8. Further Information**

#### **a. Generally**

More information on Washington taxes may be obtained by contacting the Department of Revenue, as follows:

State of Washington

Department of Revenue

Taxpayer Information and Education

711 State Avenue Northeast

Third Floor

Olympia, Washington 98504

Telephone 1-800-647-7706

The Department of Revenue also maintains an Internet site with access to laws, rules, forms, and the Department's topical publications and notices. The address is <http://www.wa.gov/>.

**b. Local Business and Occupation Taxes**

More information on local business and occupation taxes and licensing issues may be obtained by contacting the finance office of the city in question.

**c. On-line Tax Research**

The following resources may be searched on-line at the listed sites:

**i. Revised Code of Washington**

The best and most readily searchable Revised Code of Washington is available through the web site for the Municipal Research Service Center. This is a foundation that is sponsored by the Association of Washington Cities. The address is <http://www.mrsc.org/>.

**ii. Washington Administrative Code**

The Municipal Research Service Center also has a complete and easy to search set of Washington Administrative Code rules. The address is <http://www.mrsc.org/>.

**iii. Excise Tax Advisories**

These are accessible at the Department of Revenue's web site at <http://www.wa.gov/DOR/wador>.

**iv. Determinations**

These are also accessible at the Department of Revenue's web site. The address is <http://www.wa.gov/DOR/wador>.

## **E. W-2s and 1099s**

**Section E and F Authored by:** [Rob Fleming](#) CPA, *Clark Nuber P.S.*

Any entity that pays employees must prepare an annual summary of earnings and provide a copy of the form (IRS form W-2) to the employee by one month after the end of the year. If independent contractors are used and paid over \$600, a summary of payments must be prepared and forwarded to the contractor on IRS form 1099, also by one month after the end of the year.

Information about employer-employee relationships, taxable wages, the treatment of special types of employment and payments, and related matters are covered in the free IRS booklet, Publication 15 (Circular E). You may obtain this publication from the IRS by calling 1-800-829-3676.

## **F. Banking Issues**

### **1. Opening Bank Accounts**

When a nonprofit organization applies for a bank account, the bank generally requires that the Board adopt a resolution. This resolution, which typically authorizes the opening of the account, gives the persons who have the ability to sign checks the appropriate authority to do so. The bank provides you with the form of the resolution. It should be adopted following the procedures set forth in the organization's bylaws and recorded in the minutes to be kept in the corporate records.

Because nonprofits often receive monies that are restricted for particular purposes, they often open separate bank accounts to account for these amounts. Although this can and is often done, unless the donor specifically requests that his or her funds be kept separately, there is no requirement to do so. Cash accounts and investment accounts may be pooled, but the organization's accounting records need to separately account for transactions.

### **2. Cash Flow Management**

Nonprofit organizations need cash to survive sudden losses of funding and to take advantage of opportunities that may arise. Nonprofits should have three to four months of operating expenses in reserve for rainy day emergencies. Monitoring cash balances has become more difficult in recent years with the requirement that pledges and other types of gifts be recognized and recorded as income before the actual cash is received.

### **3. Borrowing**

Nonprofits may have the need to borrow cash to either cover temporary shortages in cash flow or to make major purchases. Short-term borrowing should be used for temporary shortages in cash flow. Banks will want to be sure that management has a plan of action showing there will be excess cash from which to repay the monies.

Long-term debt is appropriate for making major purchases, such as major fixed asset or other capital additions. As a general rule, it is appropriate to incur long-term debt to finance the purchase of long-term assets with the paydown of the debt approximating the depreciation of the asset.

Incurring long-term debt to take care of current cash flow needs indicates potential serious problems and should be avoided.

#### **4. Investing Excess Cash**

Excess cash balances can result from having excesses from operations, receiving large amounts of restricted contributions or from the receipt of endowment gifts. Nonprofits often do not have in-house expertise on investment management and should turn to a professional advisor for assistance. Before seeking professional help, the nonprofit should develop an investment policy outlining the types of investments and risk tolerance suitable for the organization, and whether the organization's mission would be in conflict with any corporations with which investments may be placed. A cash flow projection should also be prepared indicating when, if at all, investments will need to be liquidated for use in the operations. A professional advisor can then recommend appropriate investments and assist in monitoring.

## G. Bond Financing

**Section G Authored by:** [Judith Andrews](#), *Gottlieb, Fisher & Andrews, PLLC*

Nonprofit corporations with 501(c)(3) status embarking on a capital project which will require the incurrence of debt to pay for the project may wish to investigate the opportunity for tax-exempt bond financing. Because the interest income on such bonds paid to bondowners is exempt from federal income taxation as to such bondowners, the bonds generally carry an interest rate significantly lower than the interest rate on taxable bonds or a commercial loan with a bank. This lower interest rate on long-term debt can provide significant economic benefit for a nonprofit corporation.

However, the issuance of tax-exempt bonds to finance a project will not be a good fit for every 501(c)(3) organization and for every project. Considerations include:

1. In Washington State, 501(c)(3) organizations can participate in tax-exempt bond financing only through a governmental issuer. It cannot issue tax-exempt bonds directly. There are several of these issuers in Washington, both at the state and local levels. However, each issuer has authority to issue bonds as specified by Washington statutory law. Therefore, some issuers have authority to issue bonds for particular kinds of entities or for particular kinds of projects. For example, the Seattle Housing Authority may issue bonds to finance a low-income housing project, but may not issue bonds to finance a new wing of the Seattle Art Museum. Therefore, you will need to investigate the potential issuers carefully.
2. The issuance of tax-exempt bonds may represent an economic savings because of lower interest rates, but often the cost of the financing itself is higher than taking out a commercial loan with a bank. This is because there are more documents to be drafted and reviewed and more parties who are involved in the financing. Therefore, a project of a sufficiently large size is needed in order for the additional financing costs of a tax-exempt bond financing to make economic sense as a financing tool for a nonprofit organization.
3. When a 501(c)(3) organization benefits from tax-exempt financing, it must comply with both Washington State law and federal tax law to ensure that the bonds continue to be tax-exempt until their maturity or earlier redemption. Ongoing requirements include the limitations on the use of the facilities financed with the proceeds of the bonds, the timing of the expenditures of the bond proceeds and the investment of such proceeds.

An organization considering tax-exempt bond financing should seek the advice and assistance of an attorney or other professional qualified in this area.

## H. Issues Related to Specific Fundraising Activities

Sections H and I Authored by: [Putnam Barber](#), *The Evergreen State Society*

### 1. Washington State Gambling Commission

Many nonprofit organizations conduct raffles as a means of fund-raising. Some operate bingo games or host "Reno Nights" for the same reason. When they do so, they are subject to the laws and regulations enforced by the Washington State Gambling Commission. The Revised Code of Washington requires that gambling activities for "...the raising of funds to promote charitable or nonprofit organizations is in the public interest."

The Gambling Commission regulates bingo; raffles; punchboards and pull tabs; fundraising events (Reno nights); social card games; and amusement or carnival games of chance. It also controls business promotional contests of chance; sports pools; turkey shoots; golfing sweepstakes; bowling sweepstakes; members-only social cards and dice games; and dice or coin games for music, food, or beverage. There are several kinds of gambling or games of chance, which are not under the purview of the Gambling Commission, though, including fishing derbies.

Certain nonprofit organizations (and all 501(c)(3) organizations) are authorized to conduct unlicensed raffles when necessary criteria are met. Basic eligibility is limited to groups which have been in existence for more than twelve months, can demonstrate that they are making progress toward accomplishing their stated purposes, and have at least 15 members who elect the governing body. If your organization fits within those limits, and you are considering conducting a raffle, you should look at <http://www.wa.gov/gambling/4-164.htm> online or contact the Gambling Commission for complete information.

The complete rules governing when and how nonprofit organizations may conduct games of chance or gambling activities are too detailed and complicated to outline here. The Gambling Commission has printed materials available that describe its requirements, licenses and fees, and other considerations. Reviewing these materials is an essential first step before offering any sort of game of chance or using gambling activities for any sort of fundraising. An information packet (in .pdf format) for low-volume charitable registration is available online at <http://www.wa.gov/gambling/>.

There are also federal tax considerations that require attention before embarking on any program that includes gambling. A useful summary is in IRS Publication 3079, which can be found at [http://www.irs.ustreas.gov/forms\\_pubs/index](http://www.irs.ustreas.gov/forms_pubs/index).

The headquarters of the Gambling Commission is at 649 Woodland Square Loop SE, in Lacey (800-345-2529 or 360 438-7654). There are regional offices in Lynnwood (425-776-6751), Tacoma (253-471-5312) and Spokane (509-456-3167).

Mailing Address: P O Box 42400, Olympia 98504-2400

The Internet address for the Gambling Commission is: <http://www.wa.gov/wsgc/wsgc>.

## **2. Washington State Liquor Control Board**

Everything to do with alcoholic beverages in Washington State is regulated by the Liquor Control Board. Many nonprofit organizations host events at which liquor is served. They may also include liquor among the items sold at fund-raising auctions or as raffle prizes. Before doing any of these things, the organization should carefully review current Liquor Board rules.

Serving liquor, or organizing events where liquor is served, can expose an organization to special forms of risk. Before planning a party or any other activity involving liquor, check insurance policies with the agents to make sure they include coverage for all of the risks that may arise.

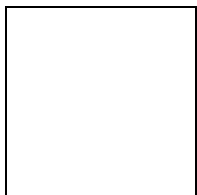
Most organizations will probably need to get a Banquet Permit from time to time. The Liquor Board's website summarized in November of 1998:

A . . . banquet permit . . . is for a private, invitation only event (not open or advertised to the public). The liquor must be provided free of charge, or brought by individuals attending the event. Package deals are allowed that may include, for example, the cost of dinner, liquor, and entertainment. To assure participants receive an equal share, tickets exchangeable for drinks may be issued as part of the package price. No separate or additional charge may be made for liquor. You can get a banquet permit for \$10 at any local liquor store or agency."

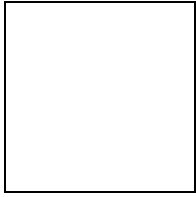
(See <http://www.liq.wa.gov/license.asp>)

A banquet permit is always required for an organization's events. If a nonprofit organization is helping to put on the event, or will benefit in some way from the program, it should get a banquet permit even if the invitations are issued in the names of individuals (board members or key fund-raising volunteers, for example.)

Nonprofit organizations can also get Special Occasion Licenses for fund-raising and other events. The Liquor Board's website explains:



A special occasion license allows a nonprofit organization to sell liquor at a specified date and place. All proceeds from the sale of liquor must go directly back into the nonprofit. 'Selling' includes soliciting donations and most package deals. The special occasion license fee is \$60 per day, per location and is limited to 12 single day events a year. The organization should apply thirty (30) days before the fundraising event. You can pick up a special occasion license application at any local liquor store or agency, or contact the Customer Service desk at (360) 664-0012



A special occasion license allows the organization to sell beer and wine (but not liquor) for off-premises consumption. Thus this license allows an auction that includes such items. A raffle that offers liquor to the holder of the winning ticket requires a special license.

There are several kinds of establishment (retailer) licenses that may be of interest to some organizations:

**a. Nonprofit Arts Organization \$250**

Allows nonprofit arts organization to sell spirits, beer, and wine to patrons for consumption on the premises at artistic or cultural performances.

**b. Private Club - Beer and Wine \$180**

Permits the sale of beer and/or wine for on-premises consumption. Beer and wine may be sold either on tap or in opened bottles or cans. Private Club licensees may not sell beer or wine for off-premises consumption.

**c. Private Club - Spirits, Beer, and Wine \$720**

To sell spirits, beer, and wine by the individual serving for on-premises consumption. Beer and wine may be sold either on tap or in opened bottles or cans. Private Club licensees may not sell beer or wine for off-premises consumption.

**d. Non-Club Event Endorsement \$900**

Allows up to 40 non-club, member-sponsored events annually using club liquor.

The Washington State Liquor Control Board has published pamphlets and guides on these and other topics available on request. The office is located at 1025 East Union Avenue in downtown Olympia. The postal address is P.O. Box 43075, Olympia, WA 98504-3075 and email can be sent to <mailto:WSLCB@liq.wa.gov>. The address for the Board's website is <http://www.liq.wa.gov/default.asp>. Customer service by telephone: (360) 664-0012.

## **I. United States Postal Service - Mailing Permits**

Many nonprofit organizations qualify to use nonprofit standard mail (which used to be called “bulk” mail) to send certain kinds of announcements at reduced cost. Under United States Postal Services rules, the organization must qualify to use these preferential rates and maintain its eligibility each year and **each mailing** must be suitable for entry as nonprofit standard mail.



*Nonprofit Standard Mail Eligibility* (publication 417) has detailed instructions about applying for authorization to mail at nonprofit rates and the kinds of mail that can be sent under such authorization. Copies are available through local post offices and from the Business Mail Entry office of the Postal Service at 4735 East Marginal Way S, Suite 1113, Seattle, WA 98134-9651 – 206 652-2200 or 800 364-3815. It is also available (in .pdf format) on the Postal Service: <http://www.usps.gov/cpim/ftp/pubs/pub417.pdf>

## **1. How to Apply**

To apply for authorization to mail at nonprofit rates, use PS Form 3624. A blank form is included in Publication 417. Once the authorization is granted, a fee must be paid and arrangements made to pay the postage for mailings. There are several options: special stamps, postage metering, or use of a deposit account from which the Postal Service will deduct the postage charges for each mailing as it occurs. The details are explained in Postal Service publications.

Not every organization that may be recognized as tax-exempt by the Internal Revenue Service under section 501 is eligible to use nonprofit mail. Generally, auto clubs, business leagues, chambers of commerce, citizens and civic improvement associations, service clubs, social and hobby clubs and trade associations will not be accepted as nonprofit mailers. There are also some sorts of organizations, particularly political groups and voting registration officials that are specifically authorized to use nonprofit standard mail.

## **2. How to Complete a Nonprofit Mailing**

Nonprofit standard mailings must be delivered to a Postal Service Bulk Mail Acceptance facility. The minimum size of a mailing is 200 pieces or 50 pounds. The pieces to be mailed must be sorted and bundled following very specific procedures. The postage rate that will be applied to the mailing will depend on the kind of sorting that has been done by the mailer. Lower rates are available for mailings when the pieces are "automation ready" by virtue of having postal service bar codes imprinted near the addresses from an address file that has been screened as the post office requires. Several Quick Service Guides outline these requirements; they can be obtained from Business Centers or on the World Wide Web. Current rates for different kinds of mailings are shown on the current versions of PS Form 3602-N for occasional mailings and 3541-N for periodicals – these forms are known as Postage Statements and are used to calculate the postage due at the time of mailing.

Many nonprofit organizations rely on mailing houses to prepare bulk mailings to these specifications. Their services range from simply sorting, bundling and delivering to the post office to comprehensive consultation about the design and strategy of a continuing mailing program. They are listed in the *Yellow Pages* under "Mailing Services."

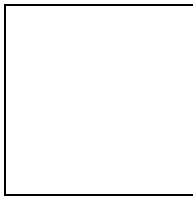
When nonprofit standard mail is presented for mailing at the Bulk Mail facility, a postal service employee will review the Postage Statement, examine the items to be mailed, and check to see if the postage charge is proper. The mailing will not be accepted if anything is amiss in any of these

areas. Errors on the Postage Statement can usually be corrected immediately. If the review of the items to be mailed suggests that they are not eligible to be mailed at nonprofit rates, you can agree to pay the higher rate in order to have the mailing go out immediately and appeal the extra charges later through an administrative process. If the mail is marked with a Nonprofit Mailing

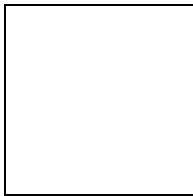
Permit number (called "nonprofit indicia" by the Postal Service) and the deposit account balance is not sufficient to cover the mailing, the facility may agree to hold it while a deposit is made. The Bulk Mail Acceptance facility does not handle money, so the deposit must be made at one of the post offices authorized for the purpose.

### 3. Troubleshooting

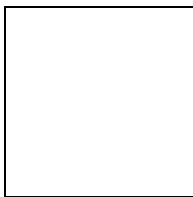
There are many features of mailings that may make them ineligible for mailing at nonprofit rates. Common problems include:



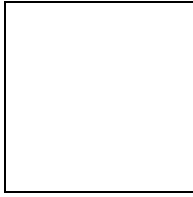
Items that are not identical. It is best to check in advance with the Post Office when there will be any variation from piece to piece.



Use of an organization's permit to attempt a mailing for another organization that has not received authorization.



"Cooperative mailings" Where more than one organization is sharing in the costs, risks, or benefits. Such an arrangement is only possible when all the cooperating organizations are authorized to mail at nonprofit rates and (unless special arrangements have been made) at the same post office.



The mailing contains promotional mention of travel, credit card, insurance or other goods or services.

There are different requirements for periodical mailings (which generally may contain advertising without loss of nonprofit eligibility). Considerations are discussed in useful detail in Publication 417.

The practice of using postage-paid reply envelopes or cards is covered by a separate set of regulations and standards. There are no special provisions for nonprofit organizations in the area of business-reply mail.

The Postal Service will review the content of planned mailings while they are in preparation. If you anticipate difficulties at the time of mailing, you can contact a Business Mail Entry office for assistance. If there are any areas of concern that remain after consulting with the Postal Service, request that the results of the pre-screening of your proposed mailing be sent in the form of a letter.

The Postal Service sends announcements and other information to authorized nonprofit mailers from time to time. It also conducts occasional training and information sessions and participates in meetings for mailers and other interested parties.

## EXHIBIT A

### ARTICLES OF INCORPORATION OF

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I [We], the undersigned, acting as the incorporator[s] of a corporation under the provisions of the Washington Nonprofit Corporation Act (Chapter 24.03 of the Revised Code of Washington), hereby sign and verify the following Articles of Incorporation for such corporation.

#### Article I: Name

The name of the corporation shall be \_\_\_\_\_  
\_\_\_\_\_ (hereinafter referred to as the “Corporation”).

#### Article II: Duration

The Corporation shall have perpetual existence.

#### Article III: Registered Office and Agent

The address of the initial registered office of the Corporation shall be \_\_\_\_\_  
\_\_\_\_\_. The name of the initial registered agent of the Corporation at such address shall be \_\_\_\_\_.

## Article IV: Purposes and Powers

Section 1. Purposes. The purposes for which this Corporation is formed are exclusively charitable, scientific, or educational and consist of the following:

A. \_\_\_\_\_.

B. \_\_\_\_\_.

C. \_\_\_\_\_.

D. \_\_\_\_\_.

E. To aid, support, and assist by gifts, contributions or otherwise, other corporations, community chests, funds and foundations organized and operated exclusively for charitable, scientific, or educational purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual, and no substantial part of the activities of which is carrying on propaganda, or otherwise attempting to influence legislation.

F. To do any and all lawful activities which may be necessary, useful or desirable for the furtherance, accomplishment, fostering or attainment of the foregoing purposes, either directly or indirectly and either alone or in conjunction or cooperation with others, whether such others be persons or organizations of any kind or nature, such as corporations, firms, associations, trusts, institutions, foundations, or governmental bureaus, departments, or agencies.

Section 2. Powers. In general, and subject to such limitations and conditions as are or may be prescribed by law, or in the Corporation's Articles of Incorporation or Bylaws, the Corporation shall have all powers which now or hereafter are conferred by law upon a corporation organized for the purposes set forth above, or are necessary or incidental to the powers so conferred, or are conducive to the attainment of the Corporation's purposes.

## Article V: Limitations

All of the purposes and powers of the Corporation shall be exercised exclusively for charitable, scientific, and educational purposes in such manner that the Corporation shall qualify as an exempt organization under Section 501(c)(3) of the Internal Revenue Code of 1986, as amended (the “Code”) or any successor provision, and that contributions to the Corporation shall be deductible under Section 170(c)(2) of the Code or any successor provision.

No substantial part of the activities of the Corporation shall be the carrying on of propaganda, or otherwise attempting to influence legislation, except as otherwise permitted to an organization described in Section 501(c)(3) of the Code or any successor provision. The Corporation shall not participate in, or intervene in [including the publishing or distribution of statements] any political campaign on behalf of (or in opposition to) any candidate for public office.

Notwithstanding any other provisions of these Articles, the Corporation shall not carry on any activities not permitted to be carried on (a) by a corporation exempt from federal and state income taxes under Section 501(c)(3) of the Code or any successor provision, or (b) by a corporation, contributions to which are deductible under Section 170(c)(2) of the Code or any successor provision.

No part of the net earnings of the Corporation shall inure to the benefit of, or be distributable, to its members (if any), directors, officers, or other private persons, except that the Corporation is authorized or empowered to pay reasonable compensation for services rendered and to make payments and distributions in furtherance of its purposes.

Upon the winding up and dissolution of the Corporation, the assets of the Corporation remaining after payment of, or provision for payment of, all debts and liabilities of the Corporation, shall be distributed to an organization or organizations, as determined by the Board of Directors, that recognized as exempt under Section 501(c)(3) of the Code or any successor provision, and used exclusively to accomplish the purposes for which this Corporation is organized.

## Article VI: Members

[The qualifications of members, if any, the application process, the property, voting and other rights and privileges of members and their liability for dues and assessments, and the method of collection thereof, shall be set forth in the Bylaws.]

## Article VII: Directors

The number of directors constituting the initial Board of Directors of the Corporation shall be \_\_\_\_\_ ( ) directors. The names and addresses of the persons who are to serve as the initial directors of the Corporation are as follows:

Name

Address

The powers and duties, number, qualifications, terms of office, manner of election, time and criteria for removal of directors shall be as set forth in the Bylaws of the Corporation.

## Article VIII: Director Liability Limitations

A director shall have no liability to the Corporation for monetary damages for conduct as a director, except for acts or omissions that involve intentional misconduct by the director, or a knowing violation of law by a director, where the director votes or assents to a distribution which is unlawful or violates the requirements of these articles of incorporation, or for any transaction from which the director will personally receive a benefit in money, property, or services to which the director is not legally entitled. If the Washington Nonprofit Corporation Act is hereafter amended to authorize corporate action further eliminating or limiting the personal liability of directors, then the liability of a director shall be eliminated or limited to the full extent permitted by the Washington Nonprofit Corporation Act, as so amended. Any repeal or modification of this Article shall not adversely affect any right or protection of a director of the Corporation existing at the time of such repeal or modification for or with respect to an act or omission of such director occurring prior to such repeal or modification.

## Article IX: Indemnification

Section 1. Right to Indemnification. Each person who was, or is threatened to be made a party to or is otherwise involved (including, without limitation, as a witness) in any actual or threatened action, suit or proceeding, whether civil, criminal, administrative or investigative, by reason of the fact that he or she is or was a director or officer of the Corporation or, while a director or officer, he or she is or was serving at the request of the Corporation as a director, trustee, officer, employee or agent of another corporation or of a partnership, joint venture, trust or other enterprise, including service with respect to employee benefit plans, whether the basis of such proceeding is alleged action in an official capacity as a director, trustee, officer, employee or agent or in any other capacity while serving as a director, trustee, officer, employee or agent, shall be indemnified and held harmless by the Corporation, to the full extent permitted by applicable law as then in effect, against all expense, liability and loss (including attorney's fees, judgments, fines, ERISA excise taxes or penalties and amounts to be paid in settlement) actually and reasonably incurred or suffered by such person in connection therewith, and such indemnification shall continue as to a person who has ceased to be a director, trustee, officer, employee or agent and shall inure to the benefit of his or her heirs, executors and administrators; provided, however, that except as provided in Section 2 of this Article with respect to proceedings seeking solely to enforce rights to indemnification, the Corporation shall indemnify any such person seeking indemnification in connection with a proceeding (or part thereof) initiated by such person only if such proceeding (or part thereof) was authorized by the board of directors of the Corporation. The right to indemnification conferred in this Section 1 shall be a contract right and shall include the right to be paid by the Corporation the expenses incurred in defending any such proceeding in advance of its final disposition; provided, however, that the payment of such expenses in advance of the final disposition of a proceeding shall be made only upon delivery to the Corporation of an undertaking, by or on behalf of such director or officer, to repay all amounts so advanced if it shall ultimately be determined that such director or officer is not entitled to be indemnified under this Section 1 or otherwise.

Section 2. Right of Claimant to Bring Suit. If a claim for which indemnification is required under Section 1 of this Article is not paid in full by the Corporation within sixty (60) days after a written claim has been received by the Corporation, except in the case of a claim for expenses incurred in defending a proceeding in advance of its final disposition, in which case the applicable period shall be twenty (20) days, the claimant may at any time thereafter bring suit against the Corporation to recover the unpaid amount of the claim and, to the extent successful in whole or in part, the claimant shall be entitled to be paid also the expense of prosecuting such claim. The claimant shall be presumed to be entitled to indemnification under this Article upon submission of a written claim (and, in an action brought to enforce a claim for expenses incurred in defending any proceeding in advance of its final disposition, where the required undertaking has been tendered to the Corporation), and thereafter the Corporation shall have the burden of proof to overcome the presumption that the claimant is not so entitled. Neither the failure of the Corporation (including its board of directors, independent legal counsel or its members, if any) to have made a determination



prior to the commencement of such action that indemnification of or reimbursement or advancement of expenses of the claimant is proper in the circumstances nor an actual determination by the Corporation (including its board of directors, independent legal counsel or its members, if any) that the claimant is not entitled to indemnification or to the reimbursement or advancement of expenses shall be a defense to the action or create a presumption that the claimant is not so entitled.

Section 3. Nonexclusivity of Rights. The right to indemnification and the payment of expenses incurred in defending a proceeding in advance of its final disposition conferred in this Article shall not be exclusive of any other right which any person may have or hereafter acquire under any statute, provision of the Articles of Incorporation, Bylaws, agreement, vote of members, if any, or disinterested directors or otherwise.

Section 4. Insurance, Contracts and Funding. The Corporation may maintain insurance at its expense to protect itself and any director, trustee, officer, employee or agent of the Corporation or another corporation, partnership, joint venture, trust or other enterprise against any expense, liability or loss, whether or not the Corporation would have the power to indemnify such persons against such expense, liability or loss under the Washington Business Corporation Act, as applied to nonprofit corporations. The Corporation may, without further membership action, enter into contracts with any director or officer of the Corporation in furtherance of the provisions of this Article and may create a trust fund, grant a security interest or use other means (including, without limitation, a letter of credit) to ensure the payment of such amounts as may be necessary to effect indemnification as provided in this Article.

Section 5. Indemnification of Employees and Agents of the Corporation. The Corporation may, by action of its Board of Directors from time to time, provide indemnification and pay expenses in advance of the final disposition of a proceeding to employees and agents of the Corporation with the same scope and effect as the provisions of this Article with respect to the indemnification and advancement of expenses of directors and officers of the Corporation or pursuant to rights granted pursuant to, or provided by, the Washington Business Corporation Act, as applied to nonprofit corporations, or otherwise.

## Article X: Bylaws

Bylaws of the Corporation may be adopted by the Board of Directors at any regular meeting or any special meeting called for that purpose, so long as they are not inconsistent with the provisions of these Articles. The authority to make, alter, amend or repeal bylaws is vested in the board of directors and may be exercised at any regular or special meeting of the board of directors.

Article XI: Incorporator[s]

The name and address of the incorporator[s] of the Corporation is [are] as follows:

Name

Address

IN WITNESS WHEREOF, the undersigned has [have] signed these Articles of Incorporation this \_\_\_\_\_ day of \_\_\_\_\_, 20\_\_\_\_.

(Signature)

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[Add signature lines for other  
incorporators if more than one]

## EXHIBIT B

### CONSENT TO APPOINTMENT AS REGISTERED AGENT

I, \_\_\_\_\_, hereby consent to serve as registered agent, in the State of Washington, for the following Corporation: \_\_\_\_\_. I understand that as agent for the Corporation, it will be my responsibility to accept Service of Process in the name of the Corporation; to forward all mail and license renewals to the appropriate officer(s) of the Corporation; and to immediately notify the Office of the Secretary of State of my resignation or of any changes in the address of the registered office of the Corporation for which I am agent.

Date: \_\_\_\_\_, 20\_\_\_\_.

\_\_\_\_\_  
(Signature)

\_\_\_\_\_  
(Type or print name of agent)

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(Street address of registered office)

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(City, state and zip code)

## EXHIBIT C

### **BYLAWS OF (Membership Corporation)**

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#### ARTICLE 1. OFFICES

The principal office of the corporation shall be located at its principal place of business or such other place as the Board of Directors (“Board”) may designate. The corporation may have such other offices, either within or without the State of Washington, as the Board may designate or as the business of the corporation may require from time to time.

#### ARTICLE 2. MEMBERSHIP

##### 2.1 Classes of Members

The corporation shall initially have one class of members. Additional classes of members, the manner of election or appointment of each class of members, and the qualifications and rights of each class of members may be established by amendment to these Bylaws.

##### 2.2 Qualifications for Membership

In order to qualify for membership, a member shall be \_\_\_\_\_. A member may be elected or appointed to membership by the Board. Members may have such other qualifications as the Board may prescribe by amendment to these Bylaws.

## 2.3 Voting Rights

2.3.1 Each member entitled to vote with respect to the subject matter of an issue submitted to the members shall be entitled to one vote upon each such issue.

2.3.2 Each member entitled to vote at an election of Directors may cast one vote for as many persons as there are Directors to be elected and for whose election such member has a right to vote[.]or may cumulate such vote and give one candidate a number of votes equal to such vote multiplied by the number of Directors to be elected.]

## 2.4 Annual Meeting

The annual meeting of the members shall be held the \_\_\_\_\_ day of \_\_\_\_\_ in each year at \_\_\_\_\_ .m. for the purpose of electing Directors and transacting such other business as may properly come before the meeting. If the day fixed for the annual meeting is a legal holiday at the place of the meeting, the meeting shall be held on the next succeeding business day. If the annual meeting is not held on the date designated therefore, the Board shall cause the meeting to be held as soon thereafter as may be convenient.

## 2.5 Special Meetings

The President, the Board, or not less than \_\_\_\_\_ of the members entitled to vote at such meeting, may call special meetings of the members for any purpose.

## 2.6 Place of Meetings

All meetings of members shall be held at the principal office of the corporation or at such other place within or without the State of Washington designated by the President, the Board, by the members entitled to call a meeting of members, or by a waiver of notice signed by all members entitled to vote at the meeting.

## 2.7 Notice of Meetings

The President, the Secretary or the Board shall cause to be delivered to each member entitled to notice of or to vote at the meeting, either personally or by mail, not less than ten nor more than fifty days before the meeting, written notice stating the place, date and time of the meeting and, in the case of a special meeting, the purpose or purposes for which the meeting is called. At any time, upon the written request of not less than \_\_\_\_\_ of the members entitled to vote at the meeting, it shall be the duty of the Secretary to give notice of a special meeting of members to be held at such date, time and place as the Secretary may fix, not less than ten nor more than thirty-five days after receipt of such written request, and if the Secretary shall neglect or refuse to issue such notice, the person or persons making the request may do so and may fix the date, time and place for such meeting. If such notice is mailed, it shall be deemed delivered when deposited in the official government mail properly addressed to the member at his or her address as it appears on the records of the corporation with postage thereon prepaid.

## 2.8 Waiver of Notice

Whenever any notice is required to be given to any member under the provisions of these Bylaws, the Articles of Incorporation or applicable Washington law, a waiver thereof in writing, signed by the person or persons entitled to such notice, whether before or after the time stated therein, shall be deemed equivalent to the giving of such notice.

## 2.9 Quorum

\_\_\_\_\_ of the members of the corporation entitled to vote, represented in person [or by proxy], shall constitute a quorum at a meeting of the members. If less than a quorum of the

members entitled to vote is represented at a meeting, a majority of the members so represented may adjourn the meeting from time to time without further notice.

## 2.10 Manner of Acting

The vote of a majority of the votes entitled to be cast by the members represented in person [or by proxy] at a meeting at which a quorum is present shall be necessary for the adoption of any matter voted upon by the members, unless a greater proportion is required by applicable Washington law, the Articles of Incorporation or these Bylaws.

## [2.11 Proxies

A member may vote by proxy executed in writing by the member or by his or her attorney-in-fact. Such proxy shall be filed with the Secretary of the corporation before or at the time of the meeting. A proxy shall become invalid eleven months after the date of its execution unless otherwise provided in the proxy. A proxy with respect to a specific meeting shall entitle the holder thereof to vote at any reconvened meeting following adjournment of such meeting but shall not be valid after the final adjournment thereof.]

## 2.12 Action by Members Without a Meeting

Any action which could be taken at a meeting of the members may be taken without a meeting if a written consent setting forth the action so taken is signed by all members entitled to vote with respect to the subject matter thereof. Such written consents may be signed in two or more counterparts, each of which shall be deemed an original and all of which, taken together, shall constitute one and the same document. Any such written consent shall be inserted in the minute book as if it were the minutes of a meeting of the members.

## 2.13 Meetings by Telephone

Members of the corporation may participate in a meeting of members by means of a conference telephone or similar communications equipment by means of which all persons



participating in the meeting can hear each other at the same time. Participation by such means shall constitute presence in person at a meeting.

## ARTICLE 3. BOARD OF DIRECTORS

### 3.1 General Powers

The affairs of the corporation shall be managed by a Board of Directors.

### 3.2 Number

The Board shall consist of not less than \_\_\_\_\_ nor more than \_\_\_\_\_ Directors, the specific number to be set by resolution of the Board. The number of Directors may be changed from time to time by amendment to these Bylaws, provided that no decrease in the number shall have the effect of shortening the term of any incumbent Director.

### 3.3 Qualifications

Directors shall be members of the corporation and \_\_\_\_\_.  
\_\_\_\_\_. Directors may have such other qualifications as the Board may prescribe by amendment to these Bylaws.

### 3.4 Election of Directors

#### 3.4.1 Initial Directors

The initial Directors named in the Articles of Incorporation shall serve until the first annual meeting of members.

### 3.4.2 Successor Directors

Successor Directors shall be elected each year at the annual meeting of members.

[The election of Directors may be conducted by mail in such manner as the Board of Directors shall determine.]

### 3.5 Term of Office

Unless a Director dies, resigns or is removed, he or she shall hold office until the next annual meeting of the Board or until his or her successor is elected, whichever is later.

### 3.6 Annual Meeting

The annual meeting of the Board shall be held without notice immediately following and at the same place as the annual meeting of members for the purposes of electing officers and transacting such business as may properly come before the meeting.

### 3.7 Regular Meetings

By resolution, the Board may specify the date, time and place for the holding of regular meetings without other notice than such resolution.

### 3.8 Special Meetings

Special meetings of the Board or any committee designated and appointed by the Board may be called by or at the written request of the President or any two Directors, or, in the case of a committee meeting, by the chairman of the committee. The person or persons authorized to call

special meetings may fix any place either within or without the State of Washington as the place for holding any special Board or committee meeting called by them.

### 3.9 Meetings by Telephone

Members of the Board or any committee designated by the Board may participate in a meeting of such Board or committee by means of a conference telephone or similar communications equipment by means of which all persons participating in the meeting can hear each other at the same time. Participation by such means shall constitute presence in person at a meeting.

### 3.10 Place of Meetings

All meetings shall be held at the principal office of the corporation or at such other place within or without the State of Washington designated by the Board, by any persons entitled to call a meeting or by a waiver of notice signed by all Directors.

### 3.11 Notice of Special Meetings

Notice of special Board or committee meetings shall be given to a Director in writing or by personal communication with the Director not less than ten days before the meeting. Notices in writing may be delivered or mailed to the Director at his or her address shown on the records of the corporation. Neither the business to be transacted at, nor the purpose of any special meeting need be specified in the notice of such meeting. If notice is delivered by mail, the notice shall be deemed effective when deposited in the official government mail properly addressed with postage thereon prepaid.

### 3.12 Waiver of Notice

#### 3.12.1 In Writing

Whenever any notice is required to be given to any Director under the provisions of these Bylaws, the Articles of Incorporation or applicable Washington law, a waiver thereof in writing, signed by the person or persons entitled to such notice, whether before or after the time stated therein, shall be deemed equivalent to the giving of such notice. Neither the business to be transacted at, nor the purpose of, any regular or special meeting of the Board need be specified in the waiver of notice of such meeting.

### 3.12.2 By Attendance

The attendance of a Director at a meeting shall constitute a waiver of notice of such meeting, except where a Director attends a meeting for the express purpose of objecting to the transaction of any business because the meeting is not lawfully called or convened.

### 3.13 Quorum

\_\_\_\_\_ of the number of Directors in office shall constitute a quorum for the transaction of business at any Board meeting. If a quorum is not present at a meeting, a majority of the Directors present may adjourn the meeting from time to time without further notice.

### 3.14 Manner of Acting

The act of the majority of the Directors present at a meeting at which there is a quorum shall be the act of the Board, unless the vote of a greater number is required by these Bylaws, the Articles of Incorporation or applicable Washington law.

### 3.15 Presumption of Assent

A Director of the corporation present at a Board meeting at which action on any corporate matter is taken shall be presumed to have assented to the action taken unless his or her dissent or abstention is entered in the minutes of the meeting, or unless such Director files a written dissent or abstention to such action with the person acting as secretary of the meeting before the adjournment thereof, or forwards such dissent or abstention by registered mail to the Secretary of the corporation

immediately after the adjournment of the meeting. Such right to dissent or abstain shall not apply to a Director who voted in favor of such action.

### 3.16 Action by Board Without a Meeting

Any action which could be taken at a meeting of the Board may be taken without a meeting if a written consent setting forth the action so taken is signed by each of the Directors. Such written consents may be signed in two or more counterparts, each of which shall be deemed an original and all of which, taken together, shall constitute one and the same document. Any such written consent shall be inserted in the minute book as if it were the minutes of a Board meeting.

### 3.17 Resignation

Any Director may resign at any time by delivering written notice to the President or the Secretary at the registered office of the corporation, or by giving oral or written notice at any meeting of the Directors. Any such resignation shall take effect at the time specified therein, or if the time is not specified, upon delivery thereof and, unless otherwise specified therein, the acceptance of such resignation shall not be necessary to make it effective.

### 3.18 Removal

At a meeting of members called expressly for that purpose, one or more Directors (including the entire Board) may be removed from office, with or without cause, by two-thirds of the votes cast by members then entitled to vote on the election of Directors represented in person or by proxy at a meeting of members at which a quorum is present.

### 3.19 Vacancies

A vacancy in the position of Director may be filled by the affirmative vote of a majority of the remaining Directors though less than a quorum of the Board. A Director who fills a vacancy shall serve for the unexpired term of his or her predecessor in office.

## 3.20 Board Committees

### 3.20.1 Standing or Temporary Committees

The Board, by resolution adopted by a majority of the Directors in office, may designate and appoint one or more standing or temporary committees, each of which shall consist of two or more Directors. Such committees shall have and exercise the authority of the Directors in the management of the corporation, subject to such limitations as may be prescribed by the Board; except that no committee shall have the authority to: (a) amend, alter or repeal these Bylaws; (b) elect, appoint or remove any member of any other committee or any Director or officer of the corporation; (c) amend the Articles of Incorporation; (d) adopt a plan of merger or consolidation with another corporation; (e) authorize the sale, lease or exchange of all or substantially all of the property and assets of the corporation not in the ordinary course of business; (f) authorize the voluntary dissolution of the corporation or revoke proceedings therefor; (g) adopt a plan for the distribution of the assets of the corporation; or (h) amend, alter or repeal any resolution of the Board which by its terms provides that it shall not be amended, altered or repealed by a committee. The designation and appointment of any such committee and the delegation thereto of authority shall not operate to relieve the Board or any individual Director of any responsibility imposed upon it, him or her by law.

### 3.20.2 Quorum; Manner of Acting

A majority of the number of Directors composing any committee shall constitute a quorum, and the act of a majority of the members of a committee present at a meeting at which a quorum is present shall be the act of the committee.

### 3.20.3 Resignation

Any member of any committee may resign at any time by delivering written notice thereof to the President, the Secretary or the chairperson of such committee, or by giving oral or written notice at any meeting of such committee. Any such resignation shall take effect at the time specified therein, or if the time is not specified, upon delivery thereof and, unless otherwise specified therein, the acceptance of such resignation shall not be necessary to make it effective.

### 3.20.4 Removal of Committee Member

The Board, by resolution adopted by a majority of the Directors in office, may remove from office any member of any committee elected or appointed by it.

### 3.21 Compensation

The Directors shall receive no compensation for their service as Directors but may receive reimbursement for expenditures incurred on behalf of the corporation.

## ARTICLE 4. OFFICERS

### 4.1 Number and Qualifications

The officers of the corporation shall be a President, one or more Vice Presidents, a Secretary and a Treasurer, each of whom shall be elected by the Board. Other officers and assistant officers may be elected or appointed by the Board, such officers and assistant officers to hold office for such period, have such authority and perform such duties as are provided in these Bylaws or as may be provided by resolution of the Board. Any officer may be assigned by the Board any additional title that the Board deems appropriate. Any two or more offices may be held by the same person, except the offices of President and Secretary.

### 4.2 Election and Term of Office

The officers of the corporation shall be elected each year by the Board at the annual meeting of the Board. Unless an officer dies, resigns, or is removed from office, he or she shall hold office until the next annual meeting of the Board or until his or her successor is elected.

### 4.3 Resignation

Any officer may resign at any time by delivering written notice to the President, a Vice President, the Secretary or the Board, or by giving oral or written notice at any meeting of the Board. Any such resignation shall take effect at the time specified therein, or if the time is not specified, upon delivery thereof and, unless otherwise specified therein, the acceptance of such resignation shall not be necessary to make it effective.

#### 4.4 Removal

Any officer or agent elected or appointed by the Board may be removed from office by the Board whenever in its judgment the best interests of the corporation would be served thereby, but such removal shall be without prejudice to the contract rights, if any, of the person so removed.

#### 4.5 Vacancies

A vacancy in any office created by the death, resignation, removal, disqualification, creation of a new office or any other cause may be filled by the Board for the unexpired portion of the term or for a new term established by the Board.

#### 4.6 President

The President shall be the chief executive officer of the corporation, and, subject to the Board's control, shall supervise and control all of the assets, business and affairs of the corporation. The President shall preside over meetings of the members and the Board. The President may sign deeds, mortgages, bonds, contracts, or other instruments, except when the signing and execution thereof have been expressly delegated by the Board or by these Bylaws to some other officer or agent of the corporation or are required by law to be otherwise signed or executed by some other officer or in some other manner. In general, the President shall perform all duties incident to the office of President and such other duties as are assigned to him or her by the Board from time to time.

#### 4.7 Vice Presidents



In the event of the death of the President or his or her inability to act, the Vice President (or if there is more than one Vice President, the Vice President who was designated by the Board as the successor to the President, or if no Vice President is so designated, the Vice President whose name first appears in the Board resolution electing officers) shall perform the duties of the President, except as may be limited by resolution of the Board, with all the powers of and subject to all the restrictions upon the President. Vice Presidents shall have, to the extent authorized by the President or the Board, the same powers as the President to sign deeds, mortgages, bonds, contracts or other instruments. Vice Presidents shall perform such other duties as from time to time may be assigned to them by the President or the Board.

#### 4.8 Secretary

The Secretary shall: (a) keep the minutes of meetings of the members and the Board, and minutes which may be maintained by committees of the Board; (b) see that all notices are duly given in accordance with the provisions of these Bylaws or as required by law; (c) be custodian of the corporate records of the corporation; (d) keep records of the post office address and class, if applicable, of each member and Director and of the name and post office address of each officer; (e) sign with the President, or other officer authorized by the President or the Board, deeds, mortgages, bonds, contracts, or other instruments; and (f) in general perform all duties incident to the office of Secretary and such other duties as from time to time may be assigned to him or her by the President or the Board.

#### 4.9 Treasurer

If requested by the Board, the Treasurer shall give a bond for the faithful discharge of his or her duties in such amount and with such surety or sureties as the Board may determine. The Treasurer shall have charge and custody of and be responsible for all funds and securities of the corporation; receive and give receipts for moneys due and payable to the corporation from any source whatsoever, and deposit all such moneys in the name of the corporation in banks, trust companies or other depositories selected in accordance with the provisions of these Bylaws; and in general perform all of the duties incident to the office of Treasurer and such other duties as from time to time may be assigned to him or her by the President or the Board.

### ARTICLE 5. ADMINISTRATIVE PROVISIONS

#### 5.1 Books and Records

The corporation shall keep at its principal or registered office copies of its current Articles of Incorporation and Bylaws; correct and adequate records of accounts and finances;

minutes of the proceedings of its members and Board, and any minutes which may be maintained by committees of the Board; records of the name and address and class, if applicable of each member and Director, and of the name and post office address of each officer; and such other records as may be necessary or advisable. All books and records of the corporation shall be open at any reasonable time to inspection by any member of three months standing or to a representative of more than five percent of the membership.

## 5.2 Accounting Year

The accounting year of the corporation shall be the twelve months ending \_\_\_\_\_.

## 5.3 Rules of Procedure

The rules of procedure at meetings of the Board and committees of the Board shall be rules contained in Roberts' Rules of Order on Parliamentary Procedure, newly revised, so far as applicable and when not inconsistent with these Bylaws, the Articles of Incorporation or any resolution of the Board.

## ARTICLE 6. AMENDMENTS

These Bylaws may be altered, amended or repealed and new Bylaws may be adopted by the vote of a majority of the number of Directors in office.

The foregoing Bylaws were adopted by the Board of Directors on \_\_\_\_\_,  
\_\_\_\_\_.

---

Secretary

## EXHIBIT D

### BYLAWS

### OF

### (Corporation without Members)

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#### ARTICLE 1. OFFICES

The principal office of the corporation shall be located at its principal place of business or such other place as the Board of Directors (“Board”) may designate. The corporation may have such other offices, either within or without the State of Washington, as the Board may designate or as the business of the corporation may require from time to time.

#### ARTICLE 2. MEMBERSHIP

The Corporation shall have no members.

#### ARTICLE 3. BOARD OF DIRECTORS

##### 3.1 General Powers

The affairs of the corporation shall be managed by a Board of Directors.

### 3.2 Number

The Board shall consist of not less than \_\_\_\_\_ nor more than \_\_\_\_\_ Directors, the specific number to be set by resolution of the Board. The number of Directors may be changed from time to time by amendment to these Bylaws, provided that no decrease in the number shall have the effect of shortening the term of any incumbent Director.

### 3.3 Qualifications

Directors shall have such qualifications as the Board may prescribe by resolution or amendment to these Bylaws.

### 3.4 Election of Directors

#### 3.4.1 Initial Directors

The initial Directors named in the Articles of Incorporation shall serve until the first annual meeting of the Board.

#### 3.4.2 Successor Directors

Successor Directors shall be elected at the annual meeting of the Board. [One-half of the number of initial Directors shall serve a term of one year and one-half shall serve a term of two years so that the term of future directors will be staggered.]

### 3.5 Term of Office

Unless a Director dies, resigns or is removed, he or she shall hold office for a term of [two] years or until his or her successor is elected, whichever is later.

### 3.6 Annual Meeting

The annual meeting of the Board shall be held the \_\_\_\_ day of \_\_\_\_\_ in each year at \_\_\_\_\_ .m. for the purposes of electing directors and officers and transacting such business as may properly come before the meeting. If the day fixed for the annual meeting is a legal holiday at the place of the meeting, the meeting shall be held on the next succeeding business day. If the annual meeting is not held on the date designated therefore, the Board shall cause the meeting to be held as soon thereafter as may be convenient.

### 3.7 Regular Meetings

By resolution, the Board may specify the date, time and place for the holding of regular meetings without other notice than such resolution.

### 3.8 Special Meetings

Special meetings of the Board or any committee designated and appointed by the Board may be called by or at the written request of the President or any two Directors, or, in the case of a committee meeting, by the chairman of the committee. The person or persons authorized to call special meetings may fix any place either within or without the State of Washington as the place for holding any special Board or committee meeting called by them.

### 3.9 Meetings by Telephone

Members of the Board or any committee designated by the Board may participate in a meeting of such Board or committee by means of a conference telephone or similar communications equipment by means of which all persons participating in the meeting can hear each other at the same time. Participation by such means shall constitute presence in person at a meeting.

### 3.10 Place of Meetings

All meetings shall be held at the principal office of the corporation or at such other place within or without the State of Washington designated by the Board, by any persons entitled to call a meeting or by a waiver of notice signed by all Directors.

### 3.11 Notice of Special Meetings

Notice of special Board or committee meetings shall be given to a Director in writing or by personal communication with the Director not less than ten days before the meeting. Notices in writing may be delivered or mailed to the Director at his or her address shown on the records of the corporation. Neither the business to be transacted at, nor the purpose of any special meeting need be specified in the notice of such meeting. If notice is delivered by mail, the notice shall be deemed effective when deposited in the official government mail properly addressed with postage thereon prepaid.

### 3.12 Waiver of Notice

#### 3.12.1 In Writing

Whenever any notice is required to be given to any Director under the provisions of these Bylaws, the Articles of Incorporation or applicable Washington law, a waiver thereof in writing, signed by the person or persons entitled to such notice, whether before or after the time stated therein, shall be deemed equivalent to the giving of such notice. Neither the business to be transacted at, nor the purpose of, any regular or special meeting of the Board need be specified in the waiver of notice of such meeting.

#### 3.12.2 By Attendance

The attendance of a Director at a meeting shall constitute a waiver of notice of such meeting, except where a Director attends a meeting for the express purpose of objecting to the transaction of any business because the meeting is not lawfully called or convened.

### 3.13 Quorum

\_\_\_\_\_ of the number of Directors in office shall constitute a quorum for the transaction of business at any Board meeting. If a quorum is not present at a meeting, a majority of the Directors present may adjourn the meeting from time to time without further notice.

### 3.14 Manner of Acting

The act of the majority of the Directors present at a meeting at which there is a quorum shall be the act of the Board, unless the vote of a greater number is required by these Bylaws, the Articles of Incorporation or applicable Washington law.

### 3.15 Presumption of Assent

A Director of the corporation present at a Board meeting at which action on any corporate matter is taken shall be presumed to have assented to the action taken unless his or her dissent or abstention is entered in the minutes of the meeting, or unless such Director files a written dissent or abstention to such action with the person acting as secretary of the meeting before the adjournment thereof, or forwards such dissent or abstention by registered mail to the Secretary of the corporation immediately after the adjournment of the meeting. Such right to dissent or abstain shall not apply to a Director who voted in favor of such action.

### 3.16 Action by Board Without a Meeting

Any action which could be taken at a meeting of the Board may be taken without a meeting if a written consent setting forth the action so taken is signed by each of the Directors. Such written consents may be signed in two or more counterparts, each of which shall be deemed an original and all of which, taken together, shall constitute one and the same document. Any such written consent shall be inserted in the minute book as if it were the minutes of a Board meeting.

### 3.17 Resignation



Any Director may resign at any time by delivering written notice to the President or the Secretary at the registered office of the corporation, or by giving oral or written notice at any meeting of the Directors. Any such resignation shall take effect at the time specified therein, or if the time is not specified, upon delivery thereof and, unless otherwise specified therein, the acceptance of such resignation shall not be necessary to make it effective.

### 3.18 Removal

At a meeting of the Board called expressly for that purpose, one or more Directors may be removed from office, with or without cause, by two-thirds of the votes cast by Directors then in office.

### 3.19 Vacancies

A vacancy in the position of Director may be filled by the affirmative vote of a majority of the remaining Directors though less than a quorum of the Board. A Director who fills a vacancy shall serve for the unexpired term of his or her predecessor in office.

### 3.20 Board Committees

#### 3.20.1 Standing or Temporary Committees

**The Board, by resolution adopted by a majority of the Directors in office, may designate and appoint one or more standing or temporary committees, each of which shall consist of two or more Directors. Such committees shall have and exercise the authority of the Directors in the management of the corporation, subject to such limitations as may be prescribed by the Board; except that no committee shall have the authority to:**

- (a) amend, alter or repeal these Bylaws; (b) elect, appoint or remove any member of any other committee or any Director or officer of the corporation;**
- (c) amend the Articles of Incorporation; (d) adopt a plan of merger or consolidation with another corporation; (e) authorize the sale, lease or exchange of all or substantially all of the property and assets of the corporation not in the ordinary course of business; (f) authorize the voluntary dissolution of the corporation or revoke proceedings therefor; (g) adopt a plan for the**

**distribution of the assets of the corporation; or (h) amend, alter or repeal any resolution of the Board which by its terms provides that it shall not be amended, altered or repealed by a committee. The designation and appointment of any such committee and the delegation thereto of authority shall not operate to relieve the Board or any individual Director of any responsibility imposed upon it, him or her by law.**

#### 3.20.2 Quorum; Manner of Acting

A majority of the number of Directors composing any committee shall constitute a quorum, and the act of a majority of the members of a committee present at a meeting at which a quorum is present shall be the act of the committee.

#### 3.20.3 Resignation

Any member of any committee may resign at any time by delivering written notice thereof to the President, the Secretary or the chairperson of such committee, or by giving oral or written notice at any meeting of such committee. Any such resignation shall take effect at the time specified therein, or if the time is not specified, upon delivery thereof and, unless otherwise specified therein, the acceptance of such resignation shall not be necessary to make it effective.

#### 3.20.4 Removal of Committee Member

The Board, by resolution adopted by a majority of the Directors in office, may remove from office any member of any committee elected or appointed by it.

### 3.21 Compensation

The Directors shall receive no compensation for their service as Directors but may receive reimbursement for expenditures incurred on behalf of the corporation.

## ARTICLE 4. OFFICERS

### 4.1 Number and Qualifications

The officers of the corporation shall be a President, one or more Vice Presidents, a Secretary and a Treasurer, each of whom shall be elected by the Board. Other officers and assistant officers may be elected or appointed by the Board, such officers and assistant officers to hold office for such period, have such authority and perform such duties as are provided in these Bylaws or as may be provided by resolution of the Board. Any officer may be assigned by the Board any additional title that the Board deems appropriate. Any two or more offices may be held by the same person, except the offices of President and Secretary.

### 4.2 Election and Term of Office

The officers of the corporation shall be elected each year by the Board at the annual meeting of the Board. Unless an officer dies, resigns, or is removed from office, he or she shall hold office until the next annual meeting of the Board or until his or her successor is elected.

### 4.3 Resignation

Any officer may resign at any time by delivering written notice to the President, a Vice President, the Secretary or the Board, or by giving oral or written notice at any meeting of the Board. Any such resignation shall take effect at the time specified therein, or if the time is not specified, upon delivery thereof and, unless otherwise specified therein, the acceptance of such resignation shall not be necessary to make it effective.

### 4.4 Removal

Any officer or agent elected or appointed by the Board may be removed from office by the Board whenever in its judgment the best interests of the corporation would be served thereby, but such removal shall be without prejudice to the contract rights, if any, of the person so removed.

#### 4.5 Vacancies

A vacancy in any office created by the death, resignation, removal, disqualification, creation of a new office or any other cause may be filled by the Board for the unexpired portion of the term or for a new term established by the Board.

#### 4.6 President

The President shall be the chief executive officer of the corporation, and, subject to the Board's control, shall supervise and control all of the assets, business and affairs of the corporation. The President shall preside over meetings of the Board. The President may sign deeds, mortgages, bonds, contracts, or other instruments, except when the signing and execution thereof have been expressly delegated by the Board or by these Bylaws to some other officer or agent of the corporation or are required by law to be otherwise signed or executed by some other officer or in some other manner. In general, the President shall perform all duties incident to the office of President and such other duties as are assigned to him or her by the Board from time to time.

#### 4.7 Vice Presidents

In the event of the death of the President or his or her inability to act, the Vice President (or if there is more than one Vice President, the Vice President who was designated by the Board as the successor to the President, or if no Vice President is so designated, the Vice President whose name first appears in the Board resolution electing officers) shall perform the duties of the President, except as may be limited by resolution of the Board, with all the powers of and subject to all the restrictions upon the President. Vice Presidents shall have, to the extent authorized by the President or the Board, the same powers as the President to sign deeds, mortgages, bonds, contracts or other instruments. Vice Presidents shall perform such other duties as from time to time may be assigned to them by the President or the Board.

#### 4.8 Secretary

The Secretary shall: (a) keep the minutes of meetings of the Board, and minutes which may be maintained by committees of the Board; (b) see that all notices are duly given in accordance with the provisions of these Bylaws or as required by law; (c) be custodian of the corporate records of the corporation; (d) keep records of the post office address of each Director and each officer; (e) sign with the President, or other officer authorized by the President or the Board, deeds, mortgages, bonds, contracts, or other instruments; and (f) in general perform all duties incident to the office of Secretary and such other duties as from time to time may be assigned to him or her by the President or the Board.

#### 4.9 Treasurer

If requested by the Board, the Treasurer shall give a bond for the faithful discharge of his or her duties in such amount and with such surety or sureties as the Board may determine. The Treasurer shall have charge and custody of and be responsible for all funds and securities of the corporation; receive and give receipts for moneys due and payable to the corporation from any source whatsoever, and deposit all such moneys in the name of the corporation in banks, trust companies or other depositories selected in accordance with the provisions of these Bylaws; and in general perform all of the duties incident to the office of Treasurer and such other duties as from time to time may be assigned to him or her by the President or the Board.

### ARTICLE 5. ADMINISTRATIVE PROVISIONS

#### 5.1 Books and Records

The corporation shall keep at its principal or registered office copies of its current Articles of Incorporation and Bylaws; correct and adequate records of accounts and finances; minutes of the proceedings of the Board, and any minutes which may be maintained by committees of the Board; records of the name and address of each Director, and each officer; and such other records as may be necessary or advisable.

#### 5.2 Accounting Year

The accounting year of the corporation shall be the twelve months ending \_\_\_\_\_.

### 5.3 Rules of Procedure

The rules of procedure at meetings of the Board and committees of the Board shall be rules contained in Roberts' Rules of Order on Parliamentary Procedure, newly revised, so far as applicable and when not inconsistent with these Bylaws, the Articles of Incorporation or any resolution of the Board.

## ARTICLE 6. AMENDMENTS

These Bylaws may be altered, amended or repealed and new Bylaws may be adopted by the vote of a majority of the number of Directors in office.

The foregoing Bylaws were adopted by the Board of Directors on \_\_\_\_\_,  
\_\_\_\_\_.

\_\_\_\_\_  
Secretary

## EXHIBIT E

### CHECKLIST FOR FORMING A 501(c)(3) ORGANIZATION

The following is a list of the legal steps for the formation of a Washington nonprofit corporation and a 501(c)(3) organization. This list does not include the many other organizational steps necessary to start up a nonprofit organization.

\_\_\_ 1. Choose a name for the organization and determine the names and addresses of a registered agent, the initial Board of Directors and the incorporator(s) for the Articles of Incorporation. Draft mission and purposes for the organization. Do a name search and reserve name if you choose (e.g. if there will be a long period of time before incorporation).

\_\_\_ 2. Draft Articles of Incorporation

\_\_\_ 3. Have two copies of the Articles signed by each incorporator and the registered agent. File both originally signed copies with the Secretary of State in Olympia with the filing fee by mail or in person.

\_\_\_ 4. Draft Bylaws.

\_\_\_ 5. With directors named in the Articles, set date, time and place for initial meeting of Board of Directors (to take place after the date of incorporation). Give appropriate notice to the initial Board of Directors of the Board meeting (at least three days notice by mail to each director).

\_\_\_ 6. At the initial Board meeting:

a. Adopt Bylaws;

b. Elect officers;

- c. Determine banking and financial arrangements;
- d. Authorize the preparation and filing of all necessary forms with the IRS to obtain 501(c)(3) status;
- e. If necessary, ratify actions and expenditures of incorporators prior to incorporation; and
- f. Conduct any other necessary business.

\_\_\_\_ 7. Complete IRS form SS-4 (federal employee identification number), have executed by officer and fax or mail to IRS.

\_\_\_\_ 8. Complete IRS form 1023 (application for tax-exempt status) and 8718 (filing fee), and, if appropriate, forms 872-C (for advance ruling submissions) and 5768 (lobbying election), have executed by officer and submit with filing fee and all exhibits to appropriate IRS office (see directions on form 1023). It is a good idea to mail the materials by certified mail and keep a copy for the corporation's permanent files.

\_\_\_\_ 9. Complete and file the Washington state Charitable Solicitation registration form, if appropriate.

\_\_\_\_ 10. Apply for Washington Master Business License, local business license and property tax exemptions as appropriate.



## EXHIBIT F

### UNANIMOUS WRITTEN CONSENT FOR ORGANIZATIONAL MEETING OF BOARD OF DIRECTORS

Organizational Meeting of

The Board of Directors of

\_\_\_\_\_

1. Meeting Deemed Duly Held. The organizational meeting of the Board of Directors of \_\_\_\_\_, a Washington nonprofit corporation, was effected by unanimous consent pursuant to RCW 24.03.155 on the date that the last Director named in the Articles of Incorporation of the corporation signed this consent resolution or a duplicate counterpart thereof. The Articles of Incorporation of the corporation were filed with, and the Certificate of Incorporation was duly issued by, the Secretary of State of the State of Washington on \_\_\_\_\_, \_\_\_\_\_. All of the Directors named in said Articles waived notice of the meeting.

2. Ratification of Actions of Incorporator. All actions of every nature heretofore taken by the Incorporator[s] for the organization and the commencement of business, if any, of the corporation were in all respects approved, ratified, and confirmed. These actions include, but are not limited to, \_\_\_\_\_ [describe actions taken by incorporators]

3. Adoption of Bylaws. The Board of Directors read, approved and duly adopted the proposed form of bylaws of the corporation, in the form attached hereto as Exhibit A, as the bylaws of the corporation. The Secretary, once elected, was authorized to authenticate the bylaws.

4. Appointment of Officers. The following persons were unanimously elected to serve in the corporate offices listed opposite such persons' names until the first annual meeting of the Board of Directors or until such persons' successors are elected and qualified:

President: \_\_\_\_\_

Vice President: \_\_\_\_\_

Secretary: \_\_\_\_\_

Treasurer: \_\_\_\_\_

5. Banking Relationship. The Board authorized the corporate officers to open such accounts for the deposit and withdrawal of the funds of the corporation, with banks and in such locations as they may deem appropriate and reasonably necessary and in the best interests of the corporation and to authorize \_\_\_\_\_ [and \_\_\_\_\_] to sign checks or otherwise make withdrawals.

The Board further authorized the President and the Secretary of the corporation, or either one of them, to execute such agreements or other documents, in the standard form provided by such banks, as are necessary to open such accounts, including, if needed, forms certifying as to the adoption of any standard form of corporate resolutions, which by their execution shall be deemed to have been authorized hereunder as if physically attached hereto and incorporated herein by this reference.

The Board further authorized the officers to change the designated signatories on the corporate checking account as seems appropriate to them and to sign the new banking resolutions showing the changed signatories and to execute such resolutions as if adopted on the date of this meeting.

6. Fiscal Year. The fiscal year of the corporation shall be the year commencing January 1 and ending December 31 of each year.

7. Tax-Exempt Status. The Board hereby authorizes the preparation and submission of the Form 1023 (application for tax-exempt status) to the IRS in order to obtain a determination of

tax-exempt status. It further authorizes the expenditure of the filing fee for such application and authorizes the President or other officer designated by the President to execute such application and all other related forms and documentation necessary for the submission of the Form 1023 to the IRS.

[add any other items of business to be approved or policies to be adopted by the Board]

The undersigned, being all of the members of the Board of Directors of the corporation, hereby waive notice of the Organizational Meeting of Directors as described above and consent to all actions taken therein.

#### DIRECTORS

_____	_____
[name]	Date

_____	_____
[name]	Date

_____	_____
[name]	Date

_____	_____
[name]	Date

_____	_____
[name]	Date



## EXHIBIT G

### IRS Form Letters Commonly Used in Exemption Application Processing

If you receive a letter from the IRS, look for a form letter number in the lower right hand corner (may also be in the upper right hand corner, or right after the signature on the letter). The list below may help you understand what the IRS wants. *Note: [DO] on a form letter indicates that it was issued by an IRS District Office, [NO] indicates the IRS National Office, and [SC] indicates a service center; [CG] on a form letter indicates that it is a computer generated letter.*

**Notice CP-515** - Request for tax return. This is strictly a form used in the 501(c)(3) application processing, but new non-profits often receive this. Some pre-printed tax forms mailed out by the IRS require follow up if the return is not filed. If you receive a Form 941 (payroll tax return) but do not have employees, you should enter all zeroes on the return and file it. If you don't, you will receive this letter, the follow-up, **Notice CP-518**, and possibly other correspondence until the IRS receives the returns.

**947** - A favorable 501(c)(3) determination letter, where the foundation status portion of the ruling (i.e., public charity v. private foundation) is “definitive” (not an advance ruling). This would be the type of letter normally received by a church, school, hospital, 509(a)(3) supporting organization, or publicly supported organization which has closed a tax year of at least eight months and requested a definitive ruling.

**948** - A favorable letter issued to an organization other than a 501(c)(3). A 501(c)(3) organization that filed its application late (after the 27 month deadline), and agreed to “prospective” 501(c)(3) status is likely to receive both this letter and a 1045.

**976** - A favorable letter issued when an organization submits amendments to the governing documents, or some other information about changes that have taken place.

**993** - A letter pointing out that the IRS has no record of tax exempt status for the organization, and cannot, therefore process Form 990.

**996** - A letter notifying the applicant that the application has been transferred to the IRS office in Washington D.C. for processing. Unfortunately this usually means a significant delay, and an increased chance of receiving a denial letter.

**1042** - The letter issued by the IRS Screener when an application is incomplete. An attachment to Letter 1042 gives details about the additional information needed and means that the application has not yet been considered on its merits.

**1045** - A favorable 501(c)(3) determination letter with an “Advance Ruling” on the applicant’s public charity status.

**1046** - The letter sent out at the end of an Advance Ruling period, requesting the information needed to make a final determination of the organization’s public charity status.

**1048** - The “Presumptive Private Foundation” letter. The organization has not responded at some stage of the Advance Ruling process, so the IRS assumes the organization does not meet the public support tests.

**1050** - The favorable letter issued when review of Advance Ruling financial data indicates that the organization meets the applicable public support tests. Do not be alarmed by the wording referring to “the act or failure to act.” This paragraph is purely hypothetical.

**1076** - The favorable 501(c)(3) determination letter issued to organizations that submit to private foundation status in the initial application.

**1312** - An inquiry letter requesting a 501(c)(3) applicant to furnish additional information in connection with the exemption application.

**1313** - A letter similar to the 1312, used with non-501(c)(3) applicants.

**1314** - “Failure to Establish” letter used when the IRS does not receive a timely response to Letter 1312. The application has been closed, but the file will be kept available for up to a year, and reopened automatically when additional information comes in. Caution! The IRS will charge a new User Fee if information is submitted more than 90 days after a case is closed using Form Letter 1314!

**1315** - A letter similar to the 1314, used with non-501(c)(3) applicants.

**2419** - A favorable group exemption letter under 501(c)(3). See Appendix C.

**5548** - A brief letter acknowledging receipt of an application. This letter is issued when the applicant’s check for the “User Fee” has cleared the bank. The IRS will mention its current average processing time.

## **EXHIBIT H**

### **IRS Publications Providing Information on Exempt Organizations**

78 - Cumulative List of Organizations Described in Section 170(c)

517 - Social Security and Other Information for Members of the Clergy and religious Workers

526 - Charitable Contributions

557 - Tax Exempt Status for Your Organization

561 - Determining the Value of Donated Property

571 - Tax Sheltered Annuity Programs for Employees of ...Certain Tax Exempt Organizations

578 - Tax Information for Private Foundations and Foundation Managers

598 - Tax on Unrelated Business Income...

892 - Exempt Organization Appeal Procedures for Unagreed Issues

1391 - Deductibility of Payments Made to Charities...

1771 - Charitable Contributions - Substantiation and Disclosure...



1828 - Tax Guide for Churches and Other Religious Organizations (Draft)

3079 - Gaming Publication for Tax Exempt Organizations

IRS Forms and Publications can be obtained -

1. By visiting your local Federal Building;
2. By calling 1-800-829-3676 (1-800-TAX-FORM), [TTY/TDD 1-800-829-4059];
3. By facsimile: dial (703) 487-4160 and follow voice prompts; and/or
4. Over the Internet.

WWW: <http://www.irs.ustreas.gov/>

FTP: ftp.irs.ustreas.gov

Telnet: iris.irs.ustreas.gov

CAUTION: Some forms and publications may not be available through all means listed.

## EXHIBIT I

### Description of and Procedure for Group Rulings

In the 1960's, to save time and paperwork for everyone involved, the IRS instituted "group ruling" procedures. These procedures allow a central organization to file a one-time request for exempt status for any subordinates affiliated with it and subject to its general supervision and control. Once the group exemption letter is issued, the IRS will generally recognize any subordinate which the central or parent organization adds to its annual roster. This relieves each of the subordinates from filing its own application for recognition of exemption.

A central organization with affiliated subordinates must obtain recognition of exempt status in its own right before applying for group exemption for its subordinates. All affiliates to be included in the group ruling must be exempt under the same paragraph of section 501(c). Each must have a written governing instrument and its own Employer ID number, even if there are no employees.

There is no IRS form for a group ruling. Instead, the parent organization applies by means of a letter setting forth the required information. (A list appears in IRS Publication 557.) Once the group ruling has been recognized, an IRS Service Center will contact the parent organization to compile a list of included subordinates. This list must be updated on an annual basis.

An organization which is tax exempt by reason of a group ruling does not receive an IRS determination in its own name. Instead, the generally accepted proof of exemption is:

- A copy of the group exemption letter issued by the IRS to the parent organization;
- A letter or certificate from the parent organization acknowledging that the subordinate is a bona fide member of the group; and
- The group exemption number (GEN), a four-digit number used by the IRS to identify that particular group.

For a variety of reasons, many nationwide groups with state and local subordinates have chosen not to apply for group ruling status for their subordinates. **CAUTION: NO ORGANIZATION SHOULD ASSUME THAT IT IS TAX EXEMPT JUST BECAUSE IT IS PART OF A GROUP.**

## EXHIBIT J

### Profiles of Typical Exempt Organizations

PROFILE: Charitable, Educational & Religious Organizations

Code Section: 501(c)(3)

Statutory Description: Corporations, and any community chest, fund, or foundation organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition...or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting to influence legislation...and which does not participate in or intervene in... any political campaign on behalf of any candidate for public office.

Exemption Application: Form 1023

Annual Return: Form 990-EZ or Form 990, plus Schedule A

Special rules: Donations are deductible as charitable contributions.

(c)(3)'s are required to file their completed application forms no later than 27 months after they are created. [Organizations which fail this 27-month rule may apply for exempt status under a different code section for the period prior to the effective dated of the 501(c)(3) status.]

(c)(3)'s usually can qualify for the special low rate non-profit bulk mailing permit.

(c)(3)'s enjoy special unrelated business income tax relief for sale or rental of mailing lists, and for activities carried on for the convenience of members, etc.

Legislative activity (lobbying) must be limited. Ordinarily, the limit is 5%, measured in a variety of ways. Most organizations, however, are permitted to elect higher limits with greater record keeping requirements.

Political activity (support of or opposition to candidates for public office) is absolutely prohibited, and will cause revocation of exempt status and the imposition of penalty taxes.

Examples: Churches, synagogues, mosques, interchurch organizations, integrated auxiliaries of churches, hospitals and their auxiliaries, clinics and medical research facilities, colleges, universities, private schools, day care centers and preschools, adult education and community schools, legal aid organizations, historical societies, environmental organizations, museums, zoos, planetariums, arboretums, symphonies, opera groups, youth organizations, non-profit personal/marriage/vocational counseling, non-profit drug/alcohol abuse prevention/treatment/rehabilitation, humane societies, scholarship funds, aid to the homeless, aid to the handicapped, aid to the elderly, combating prejudice and discrimination, protecting civil rights, evangelist and missionary groups, public television and radio.

## PROFILE: Social Welfare Organizations

Code Section: 501(c)(4)

Statutory Description: Civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare, or local associations of employees...the net earnings of which are devoted exclusively to charitable, educational or recreational purposes.

Exemption Application: Form 1024, including Schedule B

Annual Return: Form 990-EZ or Form 990

Special rules: These organizations have some similarities to 501(c)(3) organizations, but are permitted to have more than incidental amounts of social activity, and, if appropriate, unlimited amounts of legislative activity (lobbying). 501(c)(3) organizations which fail the "15 (27) Month Rule" can usually apply for 501(c)(4) status for the period prior to the effective date of their 501(c)(3) status.

Donations are not deductible as charitable contributions (except for volunteer fire departments).

(c)(4)'s usually cannot qualify for the special low rate non-profit bulk mailing permit.

Local associations of employees organized before May, 1969, may sell work-related clothes and equipment without incurring any liability for unrelated business income tax.

In some cases, (c)(4)'s may be required to notify members that a portion of dues is not deductible because of lobbying carried on by the organization.

Political activity (support of or opposition to candidates for public office) is permitted, but may not be a primary purpose of the organization, and will in most cases incur a penalty tax.

Examples: Junior Chambers of Commerce (Jaycees), Lions, Rotary, volunteer fire departments, community-wide athletic or recreational activities, festivals centered on regional customs or traditions.

PROFILE: Labor and Agricultural Organizations

Code Section: 501(c)(5)

Statutory Description: Labor, agricultural or horticultural organizations.

Exemption Application: Form 1024, including Schedule C

Annual Return: Form 990-EZ or Form 990

Special Rules: Donations are not deductible as charitable contributions, but union dues may be deductible as a miscellaneous itemized deduction. In some cases, (c)(5)'s may be required to notify members that a portion of dues is not deductible because of lobbying carried on by the organization.

(c)(5)'s can sometimes qualify for the special low-rate non-profit bulk mailing permit.

Political activity (support of or opposition to candidates for public office) is permitted, but may not be a primary purpose of the organization, and will in most cases incur a penalty tax.

Examples: Labor unions and other organizations engaged in collective bargaining or other labor negotiating, such as apprenticeship committees, and organizations promoting the interests of

persons engaged in raising livestock, crops, fish or useful or ornamental plants, such as farm bureaus or grange organizations.

PROFILE: Trade and Professional Organizations

Code Section: 501(c)(6)

Statutory Description: Business leagues, chambers of commerce, real estate boards and boards of trade, not organized for profit and no part of the earnings of which inures to the benefit of any private shareholder or individual.

Exemption Application: Form 1024, including Schedule C

Annual Return: Form 990-EZ or Form 990

Special Rules: In general, these organizations may promote the common business interests of their members through exchange of information, continuing education, labor negotiations, or lobbying, but not through the performance of specific services for members.

Donations are not deductible as charitable contributions, but dues or other amounts may be deductible as a business expense. In some cases, (c)(6)'s may be required to notify members that a portion of dues is not deductible because of lobbying carried on by the organization.

(c)(6)'s usually cannot qualify for the special low-rate non-profit bulk mailing permit.

Political activity (support of or opposition to candidates for public office) is permitted, but may not be a primary purpose of the organization, and will in most cases incur a penalty tax.

Examples: Professional associations, trade associations, chambers of commerce, convention and visitors bureaus, better business bureaus, business and professional women's clubs.

PROFILE: Social Clubs

Code Section: 501(c)(7)

Statutory Description: Clubs organized for pleasure, recreation and other non-profitable purposes, substantially all of the activities of which are for such purposes, and no part of the net earnings of which inures to the benefit of any private shareholders.

Exemption Application: Form 1024, including Schedule D

Annual Return: Form 990-EZ or Form 990

Special Rules: Social clubs are essentially "closed" in nature, dealing mainly with their own membership, rather than with the public at large.

Income is considered unrelated for UBI purposes if it is derived from non-member sources. Therefore, social clubs are usually taxed on their passive income (interest, dividends) as well as on any club receipts derived from non-member participation in club activities.

501(c)(7) organizations may not have any written policy which discriminates against any person because of race, color or religion.

(c)(7)'s cannot qualify for the special low-rate non-profit bulk mailing permit.

Donations are not deductible as charitable contributions.



Examples: Bowling leagues, hobby clubs, travel clubs, sports clubs, country clubs, yacht clubs.

PROFILE: Fraternal Organizations

Code Section: 501(c)(8) and 501(c)(10)

Statutory Description: Fraternal beneficiary societies, orders or associations.

Exemption Application: Form 1024, including Schedule E

Annual Return: Form 990-EZ or Form 990

Special Rules: Fraternal organizations must “operate under the lodge system”, with a parent organization and local lodges. This means that the IRS only grants group rulings, not individual rulings, for fraternal organizations.

(c)(8)’s, which are more common, are permitted to provide for the payment of life, sick, accident and other benefits for members and their dependents.

Donations to fraternal organizations which are to be used exclusively for religious, charitable, educational, etc. purposes, are deductible (by individuals only) as charitable contributions under the provisions of section 170(c)(4).

Examples: Benevolent and Protective Order of Elks, Daughters of the Nile, Fraternal Order of Eagles, Free & Accepted Masons, Knights of Columbus, Sons of Norway.

PROFILE: Veteran’s Organizations

Code Section: 501(c)(19)

Statutory Description: A post or organization of past or present members of the Armed Forces of the United States or an auxiliary unit or society of, or a trust or foundation for, any such post or organization.

Exemption Application: Form 1024, including Schedule K

Annual Return: Form 990-EZ or Form 990

Special Rules: (c)(19)'s must be organized in the United States or any of its possessions, and operated exclusively to benefit members.

At least 75% of the members of the organization must be past or present members of the Armed Forces. Substantially all of the other members must be cadets, or spouses, widows or widowers of past or present members of the Armed Forces.

No part of the net earnings may inure to the benefit of any private shareholder or individual.

Many veterans organizations obtained recognition of exempt status under section 501(c)(4) before 1969, when (c)(19) was added to the Code, and some have not had their ruling letters updated.

Many veteran's organizations have group rulings.

Donations to war veterans organizations are deductible as charitable contributions under the provisions of section 170(c)(3).

Examples: American Legion, Veterans of Foreign Wars.

## PROFILE: Supporting Organizations

Code Section: 509(a)(3)

Statutory Description: [A 509(a)(3) organization is a particular type of 501(c)(3) public charity]

An organization which--

(A) is organized, and at all times thereafter is operated, exclusively for the benefit of, to perform the functions of, or to carry out the purposes of one or more specified public charities

(B) is operated, supervised, or controlled by or in connection with one or more public charities

(C) is not controlled directly or indirectly by one or more disqualified persons (as defined in section 4946) other than foundation managers and other than public charities

Exemption Application: An organization claims this status when it applies for 501(c)(3) status, by completing Schedule D of Form 1023.

Annual Return: Form 990-EZ or Form 990, including Schedule A

Special Rules: Because 509(a)(3) organizations are a type of 501(c)(3), contributions are deductible under the provisions of section 170 (at the higher public charity percentage rates).

509(a)(3) organizations have an additional “organizational requirement.” Their articles of incorporation must mirror the wording appearing in the statute (see (A) above).

A 509(a)(3) organization must have a relationship with a specified public charity (or public charities) which meets one of three tests in the Regulations - “operated, supervised, or controlled by,” “supervised or controlled in connection with,” or “operated in connection with”

A 509(a)(3) organization can be established to support a 501(c)(4), (5), or (6) organization that could be considered publicly supported.

Examples: “Friends of the...” type groups, auxiliaries, or separate scholarship funds are often public charities by reason of 509(a)(3).

## PROFILE: Political Organizations

Code Section: 527

Statutory Description: A party, committee, association, fund or other organization, organized and operated primarily for the purpose of accepting contributions or making expenditures, or both, to influence the selection, nomination, election or appointment of any individual to public office.

Exemption Application: There is no application form, and the IRS does not routinely issue letters recognizing this status. Instead, political organizations “self-determine”.

Annual Return: Form 1120-POL

Special Rules: No formal charter or other governing instrument is required; the intent of the members governs whether an organization qualifies.

Political organizations pay tax, at the highest current rate, on income other than contributions, dues, fees, and assessments, proceeds from fund-raising or entertainment events, proceeds from the sale of campaign materials, and proceeds from certain games of chance.

In effect, this means that the organization will pay tax on interest, dividends, rents, royalties, capital gains, and income from the conduct of any ordinary trade or business, less related expenses. The law also provides a “specific deduction” of \$100.

Section 527 organizations are permitted to carry on voter education, social activities, or incumbent support functions, but these may not be the organization’s primary support purpose.

There are special rules governing taxation of newsletter funds, separate segregated funds created by organizations exempt under section 501(c), and for “principal campaign committees.”

Examples: Political parties, candidate's campaign organizations, political caucus organizations.

PROFILE: Homeowners' Associations

Code Section: 528

Statutory Description: See examples, and special rules below.

Exemption Application: Homeowners' associations annually elect section 528 treatment by filing a timely Form 1120-H. No other notice or application is necessary. A separate election must be made each year, and once made, cannot be revoked.

Annual Return: Form 1120-H

Special Rules: In order to qualify, an organization must receive at least 60% of its gross income in the form of dues, fees or assessments from owners, and at least 90% of its expenditures must be for acquisition, construction, management, maintenance and/or care of association property.

Substantially all of the units in a development must be used for residential purposes, and "time-share" type condominiums cannot qualify.

Electing organizations pay a 30% tax on income other than dues, fees and assessments from owners, less directly related expenses. In effect, this means the organization will pay tax on net income from non-member sources such as interest and dividends, and from member sources other than dues, fees and assessments.

The yearly election provides a unique opportunity for tax savings. An association can choose to file either Form 1120 or 1120-H each year, based on which will result in less tax.

No part of the net earnings of the association may inure to the benefit of any private shareholder.

Examples: Homeowners' associations, condominium management associations, residential real estate associations.

## EXHIBIT K

### List of IRS Forms for Exempt Organizations

1023 - Application for Recognition of Exemption Under 501(c)(3)

Contains forms and instructions needed to apply for recognition of 501(c)(3) exempt status. (Charitable, educational, religious, literary or scientific organizations.)

1024 - Application for Recognition of Exemption Under 501(a) or...Under Section 120

Contains forms and instructions needed to apply for recognition of 501(c) tax exempt status for 15 categories of organizations whose activities are other than charitable, etc.

872-C - Consent Fixing Period of Limitation Upon Assessment of Tax, etc.

Used only with Form 1023, by an organization seeking an “Advance Ruling” under sections 170(b)(1)(A)(vi) or 509(a)(2). Keeps the statute of limitations from expiring during the 5-year Advance Ruling period. Form 872-C is included in IRS Package 1023.

8718 - User Fee for Exempt Organization Determination Letter Request

Organizations seeking recognition of tax exempt status must pay a User Fee when filing Form 1023 or 1024. Form 8718 is used transmit the appropriate payment.

SS-4 - Application for Employer ID Number

Used by employers and other entities to apply for an identification number.

990 - Return of Organization Exempt From Income Tax

Annual information return filed by organizations exempt under IRC section 501(a) and described in Code section 501(c), other than private foundations, and by non-exempt section 4947(a)(1) charitable trusts not treated as private foundations.



### 990 EZ - Short Form Return of Organization Exempt From Income Tax

Annual information return used by organizations exempt under IRC section 501(a) with gross receipts of less than \$100,000 and total assets of less than \$250,000 at year end.

### 990 PF - Return of Private Foundation or Section 4947(a)(1) Trust

Annual return filed by 501(c)(3) private foundations.

### 990 Schedule A - Organization Exempt Under 501(c)(3)

Organizations described in IRC section 501(c)(3), other than private foundations filing Form 990-PF, must supply the IRS with the additional information set forth in 990 Schedule A. Attach Schedule A to Form 990 or 990EZ.

### 990 C -Farmer's Cooperative Association Income Tax Return

Annual return filed by farmers' cooperative marketing and purchasing associations.

### 990 T - Exempt Organization Business Income Tax Return

Exempt organizations with unrelated business income of \$1,000 or more must file this tax return in addition to the annual Form 990 or 990-EZ, if required.

### 990 W - Estimated Tax on Unrelated Business Taxable Income for Tax Exempt Organizations

Worksheet used by tax-exempt trusts and tax-exempt corporations to figure their estimated tax liability. This form is not to be filed with the IRS. Organizations should keep it for their records.

### 1028 - Application for Recognition of Exemption

Used by farmers, fruit growers, or similar associations to claim exemption under IRC section 521.

### 1120-H - U.S. Income Tax Return for Homeowners Associations

Annual return used by homeowners associations that qualify under section 528. Such organizations may opt to file the regular Form 1120 if it results in less tax.

#### 1120-POL - U.S. Income Tax Return for Certain Political Organizations

Annual return used by certain political organizations to report income tax. Also used by section 501(c) organizations that have incurred the section 527(f) penalty tax on political expenditures.

#### 2758 - Application for Extension of Time to File Certain Returns

File this form before the due date of Form 990, 990-EZ or 990-PF to obtain a 90-day extension. Any tax due must be paid by the original due date. Extension is not automatic. A copy of the approved extension request must be attached to the return when filed.

#### 4720 - Return of Certain Excise Taxes on Charities Under Chapters 41 and 42 of the IRC

Used by charities and other persons to compute certain excise taxes which may be due under IRC Chapters 41 and 42.

#### 5578 - Annual Certificate of Racial Nondiscrimination for a Private School

Used by private schools exempt under IRC section 501(c)(3), but not required to file Form 990, to certify to a policy of racial nondiscrimination.

#### 5768 - Election/Revocation of Election...(501(c)(3) Lobbying)

Used by certain eligible IRC section 501(c)(3) organizations to elect or revoke election to apply the lobbying expenditures provisions of Code section 501(h).

#### 7004 - Application for Automatic Extension of Time to File Corporation Income Tax Return

File this form before the due date of Form 990-T, 1120-H or 1120-POL to obtain an automatic 6-month extension. Any tax due must be paid by the original due date.

#### 8282 - Donee Information Return

Sales of certain donated assets within two years of donation date must be reported to the IRS.

#### 8734 - Support Schedule For Advance Ruling Period

Form sent by the IRS to a public charity at the end of its Advance Ruling period. Lists and categorizes support received so that the IRS can issue a final determination letter concerning private foundation/public charity status.

## Author and Committee Members Biographies

### Judith Andrews

Judy is a member of the firm Gottlieb, Fisher & Andrews, PLLC. Her practice focuses on public finance, nonprofit corporation law and municipal law. She has assisted many new nonprofit clients incorporate and obtain tax-exempt status and has been involved in many financings involving 501 (c)(3) organizations. She chaired the Young Lawyers Community Involvement Committee in 1992, where she spearheaded the writing, editing and publishing of the *How to Form a Nonprofit Corporation in the State of Washington*.

Judy is a graduate of Beloit College with academic honors and Notre Dame Law School.

### Nalani Askov

Nalani has over 15 years experience as an attorney handling employment matters from a range of perspectives including employer, union, enforcement agency and neutral arbiter. Since 1995 she focuses her law practice on investigating sexual/racial harassment complaints and other equal opportunity matters.

She graduated from the University of Washington School of Law in 1984.

### Putnam Barber

Put is the President of The Evergreen State Society, a Washington nonprofit corporation with the mission of improving the operating environment for nonprofits in Washington State and beyond. He is an Adjunct Professor in the Institute of Public Service at Seattle University, the editor of the Nonprofit FAQ at <http://www.nonprofits.org> and a frequent columnist for the *Chronicle of Philanthropy*.

He is a graduate of the University of Pennsylvania with an MA in demography and of Haverford College.

### Andrea Brenneke

Andrea represents individuals in the negotiation, litigation and appeal of employment, civil rights, and personal injury disputes with an emphasis on sexual harassment, gender and disability discrimination, and violence against women. She is a shareholder of MacDonald Hoague & Bayless.

Andrea graduated cum laude from Harvard Law School in 1992 where she served as an articles editor of the *Harvard Human Rights Journal* and as a member of the Harvard Legal Aid Bureau. She received her B.A., with distinction in Political Science, cum laude, from the University of Washington in 1988.

## **Sandy Deja**

Sandy specializes in not-for-profit tax issues for Exempt Advisory Services. She was an IRS Exempt Organizations Specialist from 1974 - 1986, where she reviewed thousands of applications for tax-exempt status and audited hundreds of nonprofit tax and information returns. She is currently in private practice, where she focuses on exemption applications, return preparation, assistance with appeals and in-depth advice to nonprofit boards on specific IRS concerns.

## **Jeffrey Even**

Jeff is an Assistant Attorney General, appointed to serve as General Counsel to the Secretary of State, and as General Counsel to the Lieutenant Governor. He has advised the Secretary of State since joining the Attorney General's Office in 1992. Jeff is also currently a member of the board of directors of the National Association of State Charity Officials.

He is a 1987 high honors graduate of the University of Montana School of Law, where he was a member of editorial board of the Law Review. In 1982 he graduated from Whitman College with honors in Political Science. Prior to joining the Attorney General's Office he prosecuted criminal cases as a deputy district attorney in California.

## **Rob Fleming**

Rob is a shareholder with the Bellevue CPA firm of Clark Nuber P.S., where he is the Director of the firm's Not-for-Profit Services Group. Rob was founder and inaugural chair of the Washington Society of CPA's Not-for-Profit Committee and is a frequent contributor to professional publications. Rob advises on organizational efficiency, board members' financial responsibility, alternative revenue sources and strategic planning. Rob focuses on serving foundations, private schools, arts organizations and social services entities.

Rob is a graduate of the University of Washington.

## **Pat Franke**

Pat is a principal in the firm Leary Franke Droppert PLLC. He acts as outside general counsel to privately held companies. He advises his clients on a wide range of business-related matters, with an emphasis on mergers, acquisitions and divestitures. He also advises his clients' board of directors

and management with respect to corporate financings, corporate governance issues, business transactions and shareholder matters.

Pat received his Bachelor of Arts *magna cum laude* from Santa Clara University in 1990, where he was elected to Phi Beta Kappa. He graduated from the University of Texas School of Law in 1993.

## **Bruce Goto**

Bruce is shareholder who chairs the Intellectual Property Group at the firm of Riddell Williams. He focuses his practice on trademark, copyright, computer and general business law, especially for clients conducting business internationally or over the Internet.

Bruce received his undergraduate degree from the University of California at Davis in 1983 and his law degree from the University of California at Berkley in 1986.

## **Mark Griffin**

Mark is a Senior Community Development Specialist with the City of Seattle's Office of Economic Development. Prior to entering the public sector, he was a commercial real estate associate with Graham & Dunn, PC.

Mark is a graduate of the University of North Carolina-Chapel Hill and the University of Virginia School of Law.

## **Tracey Hawk**

Tracey is an associate in the Seattle office of Davis Wright Tremaine LLP. Her practice focuses on the federal tax law and corporate law of nonprofit and tax-exempt organizations, as well as general federal income tax matters. Tracey counsels nonprofit organizations such as private foundations, healthcare providers, educational institutions, and social service and arts organizations on a variety of issues, including: initial qualification for tax exemption; conversions to and from tax-exempt status; unrelated business income tax; avoiding excess benefit transactions; structuring charitable contributions; complying with private foundation requirements; and tax-exempt bond financings.

Tracey graduated *cum laude* from Washington State University in 1990 with a Bachelor of Arts in Business Administration. She received her J.D. *cum laude* from Gonzaga University in 1993, where she was a Merit Scholarship recipient. Tracey obtained an LL.M. in Taxation from the University of Washington in 1996.

## David Horn

David is an Assistant Attorney General for the State of Washington, where he leads the enforcement of the Charitable Solicitations Act. He chaired the Attorney General's Executive Committee on Charitable Solicitation which developed most of the amendments to the Charitable Solicitations Act that were adopted by the legislature in 1993. From 1998- 2000 he served on the governing board of the National Association of State Charities Officials.

He is a graduate of Whitman College in 1980 and Harvard Law School in 1983. Prior to joining the Attorney General's office, he practiced law with the firm Foster Pepper & Riviera.

## Mark Hugh

Mark is a shareholder with the Bellevue CPA firm of Clark Nuber P.S., where he is the Director of the firm's State and Local Tax Group. He focuses his practice on review of over-reported taxes, missed tax incentives, omitted tax credits and transactional analysis and restructuring to reduce state tax obligations. He has represented taxpayers at all levels before the Department of Revenue and his appeals have been published in the *Washington Tax Decisions*.

Mark received an undergraduate degree from the University of Washington and a Masters degree in Federal Income Taxation from Golden Gate University.

## Stephen Katz

Stephen is an attorney practicing in Seattle.

## Julia Kittross

Since 1990, Julia Kittross has been executive director of the Philanthropy Northwest (formerly the Pacific Northwest Grantmakers Forum), an association of 180 corporate, public, community, independent and family foundations, and corporate giving programs from Washington, Oregon, Idaho, Montana and Alaska. Philanthropy Northwest's mission is to build stronger Northwest communities through effective philanthropies and does so by providing opportunities for education and peer networking about grant making logistics and all issues in which funders are involved. The managing partner of a three-year nationally and locally funded collaborative in Seattle and Portland to promote new philanthropy, Philanthropy Northwest also provides direct consulting services to foundations, corporations and individual philanthropists through The Giving Practice. See <http://www.philanthropynw.org/> for more information.

## Seema Nanda

Seema is a former associate with Davis Wright Tremaine. She is a member of the Washington State and Massachusetts Bar Associations.

She received a Bachelor of Arts *magna cum laude* from Brown University in 1992, where she was elected to Phi Beta Kappa. She graduated *summa cum laude* from Boston College Law School in 1995, where she was elected to Order of the Coif and served as an articles editor of the Boston College Law Review.

## LaVerne Woods

LaVerne Woods is a partner in the Seattle office of Davis Wright Tremaine where she heads its Nonprofit Law Group. Her practice focuses on the federal tax law and corporate law of nonprofit and tax-exempt organizations. LaVerne advises private foundations, healthcare organizations, educational institutions, social service and arts organizations. She speaks and writes frequently on issues of tax exemption and is an adjunct professor at the University of Washington School of Law, where she teaches a course on exempt organizations in the Graduate Program in Taxation.

LaVerne chairs the Washington State Bar Association's Nonprofit Organizations Committee and is active in the American Bar Association Section of Taxation Exempt Organizations Committee and the American Health Lawyers Association.

She received her J.D. from Harvard Law School, *cum laude*, in 1983 and her B.A. from Yale University, *summa cum laude*, in 1978, and was elected to Phi Beta Kappa.